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Operating a successful accounting practice : a collection of material from the Journal of accountancy Practitioners forum

Richard Collins Rea 1905-

Operating A Successful Accounting Practice

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OPERATING A SUCCESSFUL ACCOUNTING PRACTICE

A COLLECTION OF MATERIAL FROM THE JOURNAL OF ACCOUNTANCY PRACTITIONERS FORUM

EDITED BY RICHARD C. REA

AICPA American Institute of Certified Public Accountants

OPERATING A SUCCESSFUL ACCOUNTING PRACTICE

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American Institute of
Certified Public Accountants

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The material in this book has been written by experienced practitioners. It has not, however, been officially reviewed or endorsed by the American Institute of Certified Public Accountants.

Preface

This book is a collection of some of the best articles published in recent years in the Practitioners Forum of the *Journal of Accountancy*. I say "some" because many other good articles appeared in the Forum during my editorship—from 1967 to the present—and before that as well. They could not all be included for various reasons. Some dealt with auditing, accounting, and ethical standards that have since been revised. Others overlapped with material presented here. Still others did not fit into the overall structure of the book. Holding the volume down to a modest length was also a consideration. In short, this is just a sampling.

It does not purport to be a detailed guide for practitioners like the three-volume *Management of an Accounting Practice Handbook*. Rather, it is intended to complement that excellent work. Whereas the *MAP Handbook* includes authoritative discussions of all phases of practice, this book consists mainly of personal essays on a few perennial topics like practice growth, fees, relations with clients, staff recruiting and training, and relations between partners.

Some readers may be surprised to learn that so much nuts-and-bolts material has been published in the *Journal*. It is true nevertheless. It appears not only in the Forum but in other *Journal* departments and particularly in major articles. The difficulty is that practice management material tends to get lost in the welter of new accounting and auditing standards, developments in Washington, and other top-level professional matters. We thought it would be useful to extract from this material some information on running an accounting practice and bring it all together where practitioners can have ready access to it.

We have made a few changes in the texts of the original articles primarily to bring them up to date and occasionally to eliminate duplications. Original publication dates have been indicated for convenient further reference. For this and other editorial work I'd like to express thanks to William O. Doherty, former editor and publisher of the *Journal*, and to Marie Bareille and Deborah Rothschild, AICPA book editors.

I'd also like to thank the authors for their interest in professional matters and their willingness to share their knowledge with their colleagues.

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Practice Development, Planning, and Administration

Journal of Accountancy, *January 1967*

Some Suggestions for Starting a CPA Practice

James D. Brown

When I began my practice over a year ago, I did not have much information on how to start. Now I find that there was plenty of information available, that I was welcome to it, and that many established members of our profession have worked diligently to make this information available to the beginner. I want to tell you about my experience so that others will not make the same mistakes I did.

Of course, you must meet all the requirements for certification, including passing the CPA examination. These can be met by most prospective practitioners while working for others.

As soon as you are a certified public accountant, join the American Institute of Certified Public Accountants and your state society. Be an active member. Participate wholeheartedly by doing such things as writing articles, volunteering for committee service, attending dinners, lectures, conventions, luncheons, and so forth. The friends and acquaintances you make will be valuable when you start your practice. You can rely on them in coping with the problems which always arise. Keep a file of those on whom you can call for help.

A rigorous self-development program should be established early. Articles on management of accounting practices, office procedures and methods should be reviewed and studied. Especially useful are courses offered by the continuing professional education division of the American Institute of CPAs on the management of an accounting practice. Such courses should be taken as early in your program as possible because lack of time may prevent you from taking them after you have developed your practice.

It will be a good investment to purchase the *Management of an Accounting Practice Handbook* available from the AICPA. Another important source of help is the AICPA Technical Information Service.

Call on them when you need them; they will answer questions promptly.

Don't overlook key individuals in the professional organizations. You may find, as I did, that the executive secretary of your state society can be of great help.

Where will you get clients? This is a most difficult problem in the building and maintenance of an accounting practice. Clients do not flock in or drop in to see you, but you can acquire a reputation that will draw clients to you.

Getting clients is difficult and slow, but the most essential problem to solve is *money*—how to keep going until you are established. There are some proven ways that can help you. Start a personal budget. This should be done the day you first decide to start your own practice. After you have your personal budget operating effectively, plan how you are going to support yourself for the first five years. Five years might prove to be more time than necessary, but, remember, if you must shut your door and give up your practice, you will have lost a tremendous investment in time and money.

The *MAP Handbook* will be very helpful in planning how you can support yourself for five years. Remember that your credit will be greatly reduced. Planning can help solve the many problems that will arise.

I stress this five-year plan because of personal experience. Just as my practice was getting started, I had the misfortune to have several serious illnesses in my immediate family; had I not planned on the five-year period for developing my practice, this would have finished me.

Keep your own accounts on the accrual basis. This will enable you to determine all your assets. Include cash surrender value of life insurance and other assets that you don't normally consider. Also, the accrual basis will be necessary in order to budget properly. In your budget be sure to include the cost of office equipment you will need. Shop for it and get prices even though you do not plan to purchase this equipment until later. Include the cost of a telephone answering service. Don't overlook the cost of printing announcements, a tax service, and initial supplies.

By all means include public relations expenses in your budget. Evaluate the organizations you belong to with an eye toward public relations. Be wary of joining new organizations at this time as it may take quite a while to gain acceptance.

Just before you open your practice, you will need to plan a filing system, seek full- or part-time clerical help, and work out necessary forms for your own use.

When the foregoing steps have been completed you can take final action: order the announcements; order a tax service; rent office space;

purchase office furniture, equipment, supplies and forms. The planning that you did earlier will make the final work much easier.

At this point it is work, hard work, seemingly without any sense of accomplishment at times; but, in the end, it is satisfying and rewarding. The service you offer is in demand; it is unique and honorable.

Journal of Accountancy, *June 1974*

On Starting a Practice

John T. Abbott

There are many reasons why you may wish to set up a sole proprietorship. First, the time flexibility which "running your own ship" provides. Second, the financial rewards that are likely to accrue. Third, and probably most important, the belief that you can provide to the community competent professional service. Having once made the decision to start your own practice, you must bear in mind the following approaches and attitudes.

Get Started

Regardless of how technically competent you may be, you can't practice without clients. Often the emerging sole practitioner spends a great deal of time in non-revenue-producing activities. For example: the selection of an office, hiring of a secretary, arranging and setting up of files, etc. All of these are important, but it is imperative to the success of your practice that you spend a large proportion of your time solving the question, How can I get clients?

Referral business from existing clients obviously is the best and most fruitful source of business, but in a new practice that option does not exist. Therefore I suggest that you get as much exposure as possible. Meet all of the bankers, lawyers, and insurance brokers in your community, discuss your situation with experienced practitioners—your local CPA society will in all likelihood have a program for new sole practitioners—attend investment seminars, etc.

Set Up Shop

Get office space away from your home. It needn't be spectacular, but at least it should be an area that is quiet and conducive to work. Buy the finest stationery you can find and in general take on the appearance of a competent professional. The degree to which you will find overhead frightening is in direct proportion to its cost, so don't hire additional personnel too soon.

Get a Good Financial Base

You should allow yourself six to eight days a month to do something that will generate enough revenue to pay the bills, and this should be something that provides either additional technical training or affords you some further exposure. In my case, I teach a management seminar entitled "Finance and Accounting for the Nonfinancial Executive" for approximately six working days a month at various metropolitan areas around the country. This is providing income, exposure to potential consulting engagements, clients, and some pleasant traveling opportunities. It may be necessary to acquire per diem work or some other type of part-time engagement. The new practitioner has plenty of time and lots of concern about where the money is coming from. It's therefore a good idea to do something which mitigates that concern and allows you to use "working" hours to concentrate on the development of your practice.

Pick the Right Time of Year

Obviously, if you decide to start your practice in the middle of May you are going to be faced with a long period of rather slow business. Late summer or early fall is the most advantageous time in that it does not unnecessarily put your present employer in a bind when you leave and it enables you to have some time to get the exposure mentioned above. It also gives you time to prepare and plan for the coming tax season.

Keep Your Rates High

Many new practitioners are so concerned about getting business that they will take anything. This is not good for the profession and forces you to spend all of your time on areas that are not good either for your professional development or for the development of your practice. In other words, you're hurting yourself. It is difficult to be discriminating when you first start, but you should have at least a general idea of the kind of business you want. In that regard, you should keep in mind that many CPAs have built practices with writeup work, but they soon hired bookkeepers to do the writeups. If you do wish to follow this route, be sure that you don't allow yourself to get into a "writeup rut" or trapped in "public bookkeeping."

Establish Billing Policies

Send out all your bills on a timely basis and any time you do not receive payment within sixty days, stop all work for the client. This may seem strong and many well-established practitioners will tell you that it is not practical. However, cash flow is a critical problem for the new practitioner. Any time you allow one of your clients to get beyond sixty days, you are in the financing business and that is one area that should not be part of your practice. Another billing policy that should be established is something akin to the Ford Motor Company's "no unhappy owners" program. In my own practice, any time a client thinks he is being overcharged, I review the situation with him and then allow the client to make any adjustment he feels is necessary. (If a client does this more than once, I advise him that we should review our relationship once again and that he may possibly want to get another accountant.)

But, since happy clients are eventually your greatest source of business, make sure that you keep them happy. One of the quickest ways to lose a client is to be unwilling to discuss a bill. Also, I would advise against any fixed-fee arrangement with a client. There is nothing wrong, however, with a temporarily fixed fee if you quickly adjust or discontinue it when the situation warrants. My basic reservation about fixed fees is that with a new client it is difficult to estimate the time that will be required, and, therefore, a fixed-fee arrangement results in a bill that is either too low or too high.

Do It

I started my practice when I was 26 and my greatest regret is that I didn't do it sooner. The longer you wait, the greater the financial problems are. When you are 40 your personal monthly financial requirements will probably run in the neighborhood of $1,500 a month, whereas at 25 it is much easier to get by on $800 a month. There are always rationalizations for not starting your own practice, but recognize that it, like many other things in life, is reversible. Remember that you still have a salable commodity, in the event that your venture does not work out. By the same token, time continues to go by at the same speed regardless of whether you are doing something you enjoy or something you find unexciting.

Always Leave Yourself Administrative Time

Even though during the first couple of months it seems as if you are never going to get off the ground, you will quickly find that lack of time is your biggest problem. I would encourage you to allow yourself two to three days a month when you come to the office with no appointments and no specific duties. This time should be used for long-range planning, preparation of cash flows and budgets and, in general, managing the direction of your practice.

I hope that these comments prove helpful to those planning to start their own practices. I personally have found it far more rewarding, satisfying and exciting than any other venture I could have entered into. Like many other major decisions, the longer you put it off, the greater the decision becomes and the more fearful you become of your ability to succeed. Once you are committed to launching your own practice and following the guidelines as outlined above, I feel confident that the "big move" will be far less trying than you expect it to be.

Journal of Accountancy, *February 1972*

The Philosophy of a Local Accounting Firm

Ronald B. Cohen

Develop a Plan

Define the Service

The most important part of the entire concept is for you, the local practitioner, to define the service which you will provide for your clients. Every CPA starts out with tools that make him an investigator and a reporter. You can check the books, prepare a statement, complete a tax return, etc.—but so can every other CPA. The fact that you might do a better job is not usually a determining factor in the choice of an accountant because neither the client nor the public has any real way to judge your ability.

In most cases, the local practitioner who determines and reports only historical fact is judged on two factors—how much he charges and how long he takes. Any CPA who undertakes to accept and maintain assignments under these circumstances is in for an ungratifying career.

What the CPA who wants to build a practice has to do is offer something unique, something different. Naturally, you still must be an accountant, auditor, and tax return preparer, but in these capacities the client will consider you a necessary evil—pretty much like the maintenance man or the exterminator. Why not fill the tremendous void most small businesses have; why not be an adviser (business, as well as financial) and a real tax planner?

Most local practitioners will immediately respond, "Oh, but we do that, too." What they really mean is that upon a specific request, they will address themselves to a specific problem. What I advise is that you make it your primary business! Adopt the philosophy that traditional functions are only necessary evils at worst and tools for greater and more important work at best. If you can't buy this concept, then the rest of the article will be of little use to you.

Identify the Market

After the philosophy expressed above is adopted, the rest is downhill. You will be amazed at the market potential for your newly directed efforts. First let's see who won't use your services. Giant corporations will not flock to you for one of two reasons: either they will have full-time personnel capable of filling their needs or they will assume (probably correctly) that their problems are too sophisticated for your general background.

At the other end of the scale you will find small-minded businessmen who will choose an accountant using the "how much, how long" approach. These are not the kinds of clients to build a practice around. Most of them will not succeed and those who do probably will not attribute any of their success to you. All other businesses are prospects for your firm.

Stop and think how many businesses have a need (and know it) for a business adviser, a tax planner, a budgeting expert, etc. Practically the entire business community—retailers, wholesalers, manufacturers, servicing companies—needs some or all of these services. Who offers these services today? Almost nobody! Who is most qualified to offer these services? The person who knows the company's business as well as knowing business in general—the CPA. The market is truly unlimited.

Explain the Service

When discussing your firm with a new prospect, tell him that your fees will be fair and your turn-around time adequate. However, stress that if these are his only criteria the relationship will probably be unsatisfactory. Tell him what you will do for him and his company in addition to the usual statements and tax returns.

Build Your Staff

No matter how small your practice is, you and your client must both understand that routine functions are being done by you only on a temporary basis. Eventually qualified subordinates will do the auditing and you will do the important jobs, like figuring out how to save the company money.

That does not give you the right to employ inferior personnel. You must get the best help available. How do you keep pace with the nationals? It's not easy, but there is a way. First, you must invest in student interns. Use them year round on a part-time basis or full-time during summers and vacations. Since these students are uncommitted and nobody else wants them until their graduation, you normally can select the outstanding prospects. Let them work around their schedules, not yours.

Encourage these students to interview other firms upon graduation, but after they have been exposed to the exciting concept of helping businesses become successful they will come back to your firm. You must also offer competitive compensation and opportunity and not be afraid to make them partners when they are ready. They will be more valuable as partners than as competitors and those may become your only alternatives. It also creates incentive in the newer staff to see qualified employees admitted to partnership. Give new staff as much responsibility as possible as soon as they can handle it.

Set an Example

Be smart in running your own business. If you are going to merit the client's confidence, you must believe you are successful. Your office decor, your personnel, your equipment, your reports should always tell the client that you know what you're doing and are qualified to advise. If your staff turns over rapidly, how can you advise clients on how to develop and keep key people?

Do not be ostentatious or pretentious. It is not good business and you would discourage this in your clients' businesses. Be practical, creative, progressive, and humble. In other words, have the right image for a firm your size.

Spread the Word

You don't have to advertise, since every client can be a salesman. Don't be shy about letting your own clients know that what you're doing for them is unique. Your employees must also know the firm's philosophy.

Implement the Plan—Specifics

Tax Planning and Control

With the successful small businessman, nothing is more impressive than dollars in his pocket through tax savings. You must make this your number one goal! Adopt the attitude that no corporation should pay surtax until it has availed itself of every legitimate tax saving technique. Never pay an owner-shareholder a high salary when his corporation is losing money. Use pension and profit-sharing plans, Clifford Trusts, and other devices extensively. Defer income and shift it to low bracket taxpayers. Use tax shelters, but only when they make business sense. It's going to mean extra effort for you, but your client will be eternally grateful. One important point—be sure *he* knows how much you saved him.

Small Business Management Services

What the small client needs is not a sophisticated computer system or an executive training program. His needs are more basic. He needs to decide how much money he should borrow and he may even need help explaining the purpose of the loan to his banker. He wants to know if he can hire a full-time bookkeeper to free his secretary. He needs help in picking the bookkeeper. He wants to know whether to buy or lease, what kind of an incentive program will best motivate his salesmen, and how much he can take out of the business and still keep it solvent.

Your client has skills in sales, production, and maybe even administration, but it is unlikely that he knows anything about financial management. He needs your service desperately. Provide that service and he will be a loyal client indefinitely. Not only that, but he won't resent your sending out staff to prepare his interim financial reports. He knows you will be there for the decisions that count.

Get Involved

Involve yourself in the affairs of each of your clients. Be concerned over business setbacks. Call meetings and try to solve the problems. Demand buy-sell agreements. If you're driving to work and you think of an idea that will help a client, call your client with it as soon as you get to the office—even if it has nothing to do with finances. Try to talk business with every client every chance you get.

Work for the Shareholders

When you are working for a closely held corporation, don't lose sight of who your real clients are—the shareholders. The corporation is a legal entity created by the shareholders and existing at their pleasure. Within the bounds of proper tax practice and fair treatment to creditors, handle corporate funds in the manner that will most benefit the shareholders. Use that guideline as a means to determine compensation policy, investment of corporate funds, corporate guarantees of personal indebtedness and other similar matters. Don't forget, though, you are working for all the shareholders, not just the major ones.

Have Guts

Don't be a "yes man" and don't give in easily if you feel you are right. For example, if you advise your client to close a branch and he balks, don't back down. You may not always be right, but you'll be right most of the time because your decisions will be based on facts and logic, while your client will often be relying on emotions or hunches. In any event, your client will respect you for being firm and will consider you a genius when you're right. This kind of action could save a client's business or be the major turning point. Nothing can ever replace the feeling you get when a wealthy, highly respected businessman embraces you in public and says, "This is the man I owe it all to!"

Find the Answer

Approach every client problem with the idea that there is a solution. Work until you find it. Clients don't want to hear that it can't be done; all they want to know is how to do it. Remember, if the client finds his own solution, he'll wonder why you didn't think of it first and you'll be hard pressed for an answer.

Fight for Your Clients

As a concluding point, I would advise every practitioner to fight for his clients. Naturally you'll be independent on your audit, but be an advocate at other times. This should be true if you are attempting to get your client a bank loan, arguing a tax issue, negotiating merger terms, or representing him in any similar matter. You must realize that your client has no one to do this for him; if you let him down, no one will pick up the slack.

Managing an Accounting Firm— A Personalized Philosophy

Robert Boyer

Concerned accounting firms are learning to recognize the urgent need to provide their members with a more humanized practice environment, which will emphasize the importance of the individual. People are eager for the human touch in reaction to the depersonalization of the computer age, the cold disciplines of our complex business structures, and the lines of traditional authoritarianism.

One way that an accounting firm can help solve the growing needs of its members for better interpersonal relationships is to establish a philosophy of management that takes into account the dimension of humanization. What do we mean by a philosophy of management?

If a philosophy may be defined as a "system of values by which one lives," then we may define a philosophy of management as a system of values by which an organization lives. Since "system" implies consistency, it may be expressed further as a code of consistent principles consistently applied. Its tenets set up the guidelines that become part of the personality of the firm.

There are three stages in the development of an accounting firm's management philosophy:

1. Principles are formulated to guide the firm's management.
2. The content and meaning of the principles are communicated throughout the firm on a continuing basis.
3. The principles are implemented in the daily conduct of the firm's affairs.

Our examination of these stages will be confined to intrafirm relationships.

Reprinted from *Massachusetts CPA Review,* March/April 1973.

Stage 1: Formulation

The need for explicit formulation of principles is obvious. Nevertheless, it should be noted that verbalizing the principles itself imposes a discipline on thinking by forcing us to express them precisely. In addition, an accounting firm's operations demand formal statements that will help to unify policies. Furthermore, outsiders often need the guidance of formal statements. For example, prospective employees are eager to be apprised of management philosophy, as recruiters well know.

Having established the importance of a formal statement of principles, we may now define some basic concepts on which to build a management philosophy. These should be designed to fulfill the goals of the firm. Professionals today require something more than mere dollar security. They need a sense of belonging, of participating in joint endeavors with colleagues. They need to have a feeling of self-esteem reinforced by recognition and respect.

We are now ready to suggest a few principles, or guidelines, to be incorporated into a management philosophy.

Fairness

We all subscribe to the tenet of fairness, but what seems fair to the person behind the desk may be viewed quite differently by the person in front of it. To be really fair, one must take the time to inquire into the facts and make an effort to understand the other person's views. Empathy and sensitivity strengthen interpersonal relationships and lay the groundwork for evenhanded policy-making. In dealings with subordinates, the prime requirements are integrity and impartiality.

Individuality

It must be recognized that every person is unique and is entitled to be treated with dignity. Individuality is a composite of education, talent, and experience. The effort to understand the next person is not only an obligation, but also a broadening experience and one that will result in mutual respect and joint success.

Challenge

Professional people need assignments that are challenging but still within the limits of their capabilities. Groups thrive on high standards of accomplishment. Accordingly, distribution of work should stretch the capacities of the staff and reinforce exposure to a wide range of experience. The key to successful assignment of work is the matching of each staff member with the type of work that fulfills his professional appetite.

Personalized Training

The personalized training of subordinates on the job requires planning and skills that supervisors must master. Instruction can be more effective if attention is given to individual requirements as well as to adequate preparation, knowledge of sound techniques, and allocation of sufficient time. Another aspect of training involves exposure to client relationships, so that the staff member can learn the role of the experienced practitioner and the meaning of "front line" responsibility. Out of all this will come a better understanding of the meaning of each person's daily work assignment.

Appraisal and Feedback

It is important for people to know how they are doing. Appraisal of performance must be based on measurement and on comparison with accepted standards and goals. Individuals must know which aspects of their performances are going to be measured, and against which standards. Above all, they must agree to the fairness and propriety of the appraisal methods and criteria. Supervisors, on their part, must demonstrate competence in applying the most reliable means of performance appraisal.

The method for providing feedback must be tailored to individual personalities. Secure people can take criticism more easily than those who are insecure; sensitive people will pick up nuances that the insensitive may miss. In offering criticism and suggestions, the supervisor is more than a mere transmitter of information; he is a receiver, too. As a receiver, he must observe, evaluate, and respond to reactions from his subordinates.

As one executive put it, "How many communicators really understand the basic underlying principle of communication? How many well-conceived, well-planned programs of communication really consist of a one-way stream of information that inundates and frustrates and frequently irritates the poor individual on the receiving end? Remember, unless you are receiving as well as transmitting—unless you are getting a response—you really aren't communicating at all."

Individual Advancement and Rewards

While the precise timing of an individual's progress is subject to organizational constraints, the following of an orderly career path should be possible.

Personnel actions relating to compensation, promotion, and separation must conform to a structure that recognizes differences in duties and responsibilities while providing fair rewards for service and performance. In the long run, a firm's success depends on the efforts of people it has encouraged to perform at peak effectiveness.

Promotion From Within

Efforts to develop competent people from within serve three purposes:

1. The beneficiaries themselves are encouraged in pursuing their careers.
2. Others on the way up can be replaced by those who are ready to assume more responsibility.
3. The firm is enabled to follow a policy of promoting from within those who are best qualified.

Accordingly, each person desiring advancement must seek to train at least one capable replacement to take over his responsibilities.

Delegation of Responsibility

The most effective way to enable a person to achieve higher levels of responsibilities is to delegate to him as much responsibility and authority as he can accept. There is always an abundance of responsible assignments, so that delegation is always feasible and always necessary. Delegators do not abdicate, however; they merely exchange one type of responsibility for another. They must consistently apply "follow-up" disciplines to ensure the success of the delegation process.

Participation

It is axiomatic that professionals like to participate in problem-solving and policy-making. Those who are invited to join in such activity must be assured that their opinions will be respected and that they will indeed have something to say about the outcome. It follows that issues for participation must be selected carefully. They must be neither so difficult as to be beyond the capacities of subordinates nor so simple as to appear trivial.

Commitment on the part of individuals and groups to become involved in assisting management should be sought. For example, the establishment of management advisory groups at lower echelons to help solve problems and make recommendations that will further the progress of the firm will serve many purposes. Not only will this type of program promote a free exchange of ideas, but it will also provide the participants with executive training and help identify those who have management talent. Furthermore, it is well known that people will more readily support policies when they are involved in the formulation process.

Receptivity to Innovation

Effective management must create an atmosphere which encourages the person who seeks innovation. By providing a forum which welcomes creative ideas, a firm will open the door to fresh solutions of its problems and a free exchange of imaginative thinking.

The chairman of the board of the American Management Association has said, "It is hard to realize why almost paralyzing fear of error curbs the initiative of so many men in management . . . and causes able men to 'keep their noses clean and their mouths shut.'"

The positive attitude that "there is always a better way to do anything" should overcome the fear of change and enable a firm to find better techniques to replace barnacled methodology. For the innovator, a climate of receptivity can only stimulate his creativity and increase his opportunities for self-fulfillment.

Stage 2: Communication

A set of principles may be formulated, but it doesn't carry much weight until it is implemented. Between formulation and implementation lies another stage: communication. The faithfulness with which the principles are transmitted will affect their execution.

A communication network should operate in several directions. Communication downward should offer an understanding of the rationale behind management decisions; communication upward should provide management with sufficient awareness of progress and developments; and communication sideways should support cooperation and promote efficiency.

Open communication should be encouraged. Objectives, policies, and plans should be carefully transmitted, with the sensitivities and concern of the recipients kept in mind. News of developments should be passed on rapidly. In particular, the upward transmission of bad news must not be impeded or delayed. Realistically, however, certain matters are better handled confidentially, and some subjects are too inconsequential to permit them to clutter up the lines of communication. In all other matters, an atmosphere of free and open communication must prevail.

In any effective communications network, departmental or local-office work groups must not be ignored, nor their importance underestimated. From the standpoint of the individual, it is a matter of considerable concern to him that he belong to a group and that his group make a significant contribution to the firm's activities. From the standpoint of the local office, it is the group that adopts standards and values, and it is the group that enforces conformity to its code.

Management ignores such team units at its peril. In fact, the route to successful implementation of a set of principles is to gain acceptance for them by these work groups. This approach will arouse much more enthusiasm than the alternative of cold directives handed down by an authoritarian management without preview or warning.

Another matter easily overlooked is the impact of subtle forms of communication. Messages are conveyed in many ways, not all of them verbal. For example, when a man brings his problem to his superior and he expects to be listened to and helped, the superior's behavior may speak louder than his words. If he looks for papers, answers telephone calls, fidgets, and keeps glancing at his watch, all the while saying, "Go ahead, I'm listening," the employee might just as well save his breath.

To illustrate further, if the authoritarian types in an office are praised and recognized and promoted, while the democratic leaders are ignored, the entire staff will conclude that, in this organization, nice guys do indeed finish last. There can be no gap in democratic leadership. It must be part of the firm's personality from top management to first-line supervision. A split personality can cause more mischief than a consistently dictatorial one.

In communicating the firm's philosophy, then, management must seek and win acceptance and support at all levels.

Stage 3: Implementation

The day-by-day commitment to a management philosophy is as important to a firm as the daily commitment to technical and professional matters or to client relationships. To repeat, the philosophy of management is the system of values by which the firm lives; it is the code that molds the firm's personality.

Supportive relationships can assist implementation of the management philosophy. Each member of a firm is entitled to know that others have a personal and vital interest in him and that when the occasion arises, someone will stand behind him and represent him. Each subordinate should always be able to turn to someone who will act as his mentor and counselor. This problem is solved in some firms by a formal arrangement whereby everyone on the staff has a specific adviser to consult.

An evaluation procedure should be followed that gives credit for good performance and makes criticism constructive. Periodic reviews of performance and progress should let each person know how he is doing, and care should be taken to acknowledge strengths as well as weaknesses.

Management at every level should constantly reappraise its dealings with all members of the firm to make sure the behavior exemplifies the established philosophy. One firm evaluates its top managerial staff by scoring each person on the following areas of interpersonal practices.

Relationship With Staff

1. Shows that he enjoys his work and gets satisfaction from its accomplishment.
2. Encourages the staff to express their ideas and opinions.
3. Gives personal attention to individuals.
4. Understands staff problems.
5. Gives support to staff in their actions.
6. Expresses appreciation for a job well done.

Planning

1. Provides opportunity for staff participation in establishing goals.
2. Provides for maximum client participation and coordination.

Organization

1. Clearly explains each staff member's area of responsibility.
2. Shows each staff member how his work fits into the overall engagement.
3. Delegates responsibility and authority.
4. Avoids encroaching on responsibility once he delegates it.

Communication

1. Keeps well informed on the accomplishments and feelings of the staff.
2. Listens understandingly to questions and problems.
3. Explains the "why" of his decisions.
4. Invites criticism of his actions.
5. Keeps the staff currently informed of the progress of the work.
6. Expresses himself clearly.

Development of Staff

1. Provides opportunity for staff to improve skills and abilities.
2. Lets staff know how they are doing.
3. Uses constructive criticism.

The structure of assignments can also either help or hinder a person's growth. Staff should be encouraged to plan and control their own work as soon as they are ready to take on these responsibilities. At the end of each engagement, the staff should review procedures and submit suggestions for improvement in future engagements. A positive response should be made to the suggestions.

Finally, the growth of the firm and its organizational structure must never depersonalize its efforts to establish the proper humanized climate of professional motivation and self-fulfillment. Management has a compelling responsibility to implement its philosophy throughout the firm. Dedication to this trust should be manifested by each person in authority as part of his daily work. He must live it, practice it, and exemplify it. Clarence Francis aptly said "Every great institution . . . is the lengthened shadow of a single man. His character determines the character of his organization. In the same way every department, every section, every unit within that organization is the lengthened shadow of the executive, manager or supervisor who heads that particular group. The kind of person he is determines the kind of ideals and goals his people will adhere to. It's that simple, that important, that fundamental for the success of the entire organization."

Summary

There is a mutual exchange of faith when those associated with a firm dedicate their careers and professional lives to the organization in exchange for management's pledge to assist each member in achieving goals of self-fulfillment. The concepts and principles offered here are intended to reinforce this pledge.

The keystone that holds the structure together is respect for the dignity of individuals and for the group relationships that social beings inevitably form. This should pose no problems, for we are all involved in a common cause.

This kind of supportive environment encourages the professional growth of the individual and provides a climate for the success of the organization.

Journal of Accountancy, *May 1971*

The Unlimited Future of the Sole Practitioner

J. J. Dapice

CPAs have a far greater professional capacity to serve the public than they are using.

Too often they devote too much attention to write-up work and invoicing for clients, while necessary professional accounting services are not being performed at all or are being performed by nonprofessionals.

It was with this realization that I returned to public practice nine years ago and started rendering professional accounting services in the way they should be rendered.

Development of a Practice

The town I practice in—New Canaan, Connecticut—has little commercial activity. Its residents are higher-income commuters. Their principal need is financial advice and tax planning.

These are sophisticated people. To serve them, a CPA must have not only technical proficiency but current knowledge of events in a variety of fields affecting the client.

Professional accountants must have clients accept them as authorities. Only then will clients reveal the full scope of their financial activities and enable the accountants to point out areas of financial improvement. Many of my clients started as tax clients and now seek advisory services the year round.

The following are the areas in which I serve my clients:

Buying a business—
- Evaluate purchase price.
- Evaluate future of business.
- Evaluate capability of clients to be successful.
- Establish best tax base.

Selling a business—
- Assist in setting price.
- Establish best tax basis of selling.
- Determine if liquidation or a stock sale is preferred.

Divorce—
- Give pre-divorce advice.
- Indoctrinate alimony recipient about finances and taxes.
- Determine impact of financial problems on dependent children.
- Arbitrate between ex-wife and ex-husband.

Buying vs. leasing equipment and cars.

Setting up a profit-sharing or pension plan for a corporation or a sole practitioner.

Setting of prices for a new venture.

Advising on financial aspects of gifts in forms of trusts or gifts to minors.

Evaluating investment schemes in real estate.

Advising widows and widowers contemplating marriage on future distribution of current funds and assets.

Setting fair reporting standard with local tax authorities regarding personal property tax base.

Old people—
- Medicare.
- Medical expense.
- Prepare for retirement.

Working spouses and children—
- Determine spouse's share of taxes on income.
- Determine net income after tax and expense and cost of occupying their time.
- Guide young people who are achieving increased incomes on how to plan their disposition and accumulation.

Evaluating management decisions.

Advising on handling of inherited wealth.

Advising on handling of nurses in a major illness, Social Security reporting, Medicare, etc.

Indoctrinating spouses of sick or dead mates in recordkeeping.

Counseling on use of funds in investments.

Taking or leaving insurance proceeds upon maturity.

Buying a new house or making any other major purchase.

Leading client acquired after bankruptcy out of bankruptcy.

Neutralizing overspenders and preparing them for lower-income retirement pay.

Timing real estate market for selling purposes.
Setting basics for establishing a franchising operation.
Establishing potential of a business.

Fees

CPAs' competence and personal interest in their clients' affairs, plus the giving of at least a dollar's value for a dollar received, are important elements in the clients' willingness to pay CPAs' fees. In many instances the work is being done for the first time and a standard for comparison does not exist. Thus, a basic trust must exist.

It is impractical to set a fee at the start of a client relationship and I seldom do so. If the client has used an accountant previously, I will evaluate changed conditions and indicate a "ball park" estimate.

Seldom is an hourly rate quoted. When it is asked for, an average may be given.

Flexibility is important in setting fees. The analysis of a problem may reveal the potential for major tax savings. A fee limitation can inhibit tax research to accomplish this.

Hours

In nine years, I have started work as early as 7:30 A.M. during the tax season and I rarely work beyond 5:00 P.M.; 12 noon on Saturdays during the tax season only; never on Sunday. The staff has never worked beyond 9:00 to 5:00 weekdays.

Excessive overtime dulls the creative ability of a person and does not allow enough time for current reading and professional development.

In a growing practice, it is desirable to have more help available than is immediately needed. I failed to do this myself one year and consequently had to turn away some repetitive tax engagements. This is an example of the kind of "economy" that loses revenue.

Evaluation of This Approach

Net income, hours worked, and the quality of clients attracted are important bases for evaluating a professional practice. For nine years I have earned an above average income without putting in excessive overtime. Over 90 percent of my clients return for tax and other work, and each year they request additional assistance. Often their remittances contain notes of appreciation, and recommendations by clients to their friends are frequent.

This demonstrates that a sole proprietor can build a successful professional practice.

Opportunity to Serve

At a time when business is accused of not being socially conscious, a CPA is afforded a wonderful opportunity to make a major and continuing contribution to the general welfare.

By assisting in achieving financial health for clients the CPA enables them to earn more, give opportunity to others, and provide funds for social betterment through the payment of taxes. CPAs can also assist nonprofit groups to operate more efficiently and thereby offer more services to the public.

Favorable Growth Factors

Throughout the country there are millions of people like my clients earning a sufficient income to justify the use of a CPA. Many are not doing so. Many even prepare their own tax returns.

Only partnership and corporate tax returns require balance sheets. However, balance sheets for individuals and unincorporated businesses are also essential.

I prepared and distributed to clients a pamphlet entitled "A Plan for More *After-Tax* Income." The pamphlet encourages personal balance sheet preparation and highlights the important areas of financial and tax planning. Year-round use of the CPA is encouraged.

From time to time a financial or tax development makes it desirable to issue a memorandum to clients. A nominal fee is charged for these memorandums and incorporated into the regular fee. Client response has been gratifying. CPAs who keep their clients informed demonstrate continuing interest in the client's financial and tax affairs.

It is essential for the younger generation to find the accounting profession challenging and rewarding if the profession is to maintain its vitality and grow.

I have always felt that the CPA helps people in a variety of ways: assisting in maintaining the solvency of a business and making it grow, expanding employment opportunities, providing incentive toward more profits and more taxes being paid.

Yet some of the children of older CPAs have not been sold on their fathers' profession. My three sons, all good students, decided that the accounting profession was not for them. It may be that they remember the conditions I had to work under in the past—conditions that have long since been substantially improved.

The need exists to make younger accountants (not to mention the overworked and underpaid older practitioner) aware that there is a better way and an unlimited future for the sole practitioner.

Journal of Accountancy, *March 1969*

The Glowing Role of the Local Practitioner

James P. Thompson

To paraphrase Mark Twain, the reports of the demise of the local practitioner are greatly exaggerated. The advantages of this type of practice for both practitioner and client may long outlast the prophets of doom occasionally heard. Undoubtedly these are uncharted waters which such persons have never navigated personally and, therefore, regard fatefully.

Lest future young hopefuls be discouraged from trying to establish themselves in such a pleasant career, perhaps someone ought to tell it to them "like it is"—at least for some of us who have enjoyed success in this particular niche in life. For what it's worth, then, here is one man's view of the advantages of practicing as a sole proprietor.

Income

It won't be as high as that of top CPA firm partners (who are statistically few among all practicing CPAs) but it should be comparable to their middle management employees if you are of their caliber.

Satisfaction

Would you rather be a big frog in a little pond or a little frog in a big pond? The answer may be the key to your whole satisfaction. It may be the underlying motivation behind our whole entrepreneurial system, but let's leave that to the psychologists to probe further. Meanwhile, you decide about you.

Prestige

The community generally will regard you as it does the local attorney or doctor. Your peers will judge you correctly on your abilities. The "in" group in the legal, accounting, banking, and *Fortune* 500 fraternity may regard you as a "back-alley shop," but you won't concern yourself with what they think. Your clients will think you're great.

Responsibility

You will be master of your fate and captain of your soul. That can be both challenging and frightening. There is no one else to share the responsibilities with, but then you enjoy all the credits.

Continuing education and training are advantages of a larger firm and you may expect your work will be scheduled, supervised, and reviewed there. However, as a local practitioner you must have the self-discipline to accomplish all of this on your own if you are to serve your clients best.

Hours

As to hours, any well-managed firm can tell you about this, but I must beg off. I can't. I never counted them other than to bill out my chargeable time and then forget it. I just manage to keep busy or take off for the beach with my family when things are slow, and seem to enjoy all the hours spent either way. Incidentally, hours won't have to conform to a 9-to-5, five-day-a-week pattern. You will work when the work is to be done and until it is done, but the ten-hour days tend to balance out with the five-hour days over the year.

Your Office

As to mundane matters such as office furnishings, you can enjoy whatever you care to spend. Based on experience both ways, I do suggest an office close to home, though. It will add years to your life and the clients really don't seem to care, inasmuch as you do most of your work in their offices anyway. They are hiring your talents, not your premises. If this seems contrary to the philosophy of building a firm image, you must understand that you are your own image when you practice on your own.

Level of Work

You will rarely consolidate foreign subsidiaries, worry over SEC reports, or tackle highly technical MAS problems. On the other hand, you'll have a lot of variety in your work. You can't delegate tax planning, audit problems, or systems work to a special department when you're practicing alone.

A national firm partner worried me one time by comparing solo practice to a decathlon where you had to be an expert in many fields of increasing complexity. The fact is that a good all-round practitioner enjoys variety, finds that the complexity of none of the local level problems matches those on his CPA examination, is fascinated with new developments, knows where to find expert assistance, and just couldn't enjoy the narrow confines of specialization. In my practice I've done municipal auditing, installed data processing, designed cost accounting systems, fought IRS up through appellate, advised corporations, partnerships, and proprietors, and consulted on myriad problems, all of which have proved stimulating.

As to write-up work, you can train clients' staff to record the journals on pegboard and utilize data processing to post the general ledger and produce statements. You can render professional service as needed and wait for the clients to grow.

Business Aspects

With a Dale Carnegie type course, you can manage practicing your profession on your own. Also, you don't have to spend a lot of time on staff recruiting and training; it must be discouraging when you figure CPA firms have to do it all over again each year. Anyway, who needs juniors since IBM arrived on the scene to do the bookkeeping and prepare tax returns better, faster, and cheaper than you could?

Contacts are important, though, and one of the best sources of new clients, I have found, is through attorney recommendations. They make them readily when they've learned you can deliver trouble-free results. They may also prefer to deal with someone their own size.

Security

As to your job in a big firm, all your eggs are in one basket versus enjoying bits of income from many clients. But while the bits may total more, even they must be replaced from time to time and it hurts when one disappears and your income dips 30 per cent for a time.

Of course, it's simply not true that sole practitioners have all the advantages. We are at a disadvantage when it comes to sickness, retirement, and death. Income stops when chargeable hours stop. Just keep your fixed expenses low (pay generous per diem before you consider permanent assistants), buy insurance, stay healthy, and keep up acquaintances with fellow practitioners who might heed a call for help. You are in the same boat as the nonvanishing lawyer or doctor.

Career Goals

I left the business world in order to become a professional man. When I first joined an accounting firm, I cast my eye on the senior partner's desk. The top echelon of the business world may have come up the ladders as engineers, accountants, or salesmen, but they finally leave their specific fields and become executives managing money, men, and time. In a profession it seemed one would stay in his chosen field. No one had told me that a senior partner also had become a business executive and left the practice of accounting largely to his technical assistants who were also soon to move up or out. Such was not my goal. Can you imagine doctors visualizing the day when they would no longer treat their patients but instead administer a medical complex? Some will, of course, but perhaps the contrast in the two professions is the reversal of goals in the CPA firms. Well, young idealists, there is a branch of the CPA world where you can proudly practice your chosen profession for the rest of your life. That is the career goal of the local practitioner.

Client Service

Obviously, no firm of people, however well organized, can match the direct personal service of one man. Continuity is another problem where continuously changing personnel perform the services. Motivation is naturally higher for a principal than an employee, even if his experience were equal, so that the resulting performance for the client is higher. Finally, the overhead incurred by a firm to offset these inherent limitations is an additional cost to be passed on to the client. It is economically justifiable then only where big business requires a big firm to service its account.

Thus the local practitioner can better serve small business. A glowing role does exist for the local practitioner and he is not about to vanish when growing numbers of clients seek his personal services.

Journal of Accountancy, *June 1973*

Planning the Growth of Your Practice

William J. Mayhugh

The upgrading and expansion of a practice requires planning—planning in general, planning for personal professional development, and planning for your particular practice. In this article, I begin with a discussion of these three concepts of planning. Then I make some suggestions for the upgrading and expansion of the practice in its major areas: accounting, auditing, tax, and management advisory services.

How to Plan

The importance of developing a plan both for the upgrading and expansion of your practice and for your own individual life cannot be overemphasized. Without it, you will not live up to your full potential as a professional CPA or as a human being.

The plan must be more than simply a projection of the future on the basis of the past, though a study of past performance is a necessary part of the forecast. Planning must include your own powers of reasoning and imagination about the future, as well as careful inferences from information about the past. You must seek the unexpected and consider it for your plan.

In his book, *Managing for Results,* Peter Drucker has made some suggestions on how to look for the unexpected in making a plan. He recommends that all the standard questions—such as, Who is the customer? Where is the customer? What does he buy?—be supplemented with questions which force the planner to seek the unexpected. We might ask: Who is the noncustomer? Or, in our case, we might consider: Who are our nonclients? Ask yourself what would enable your present clients to do without your services.

Your Personal Plan

Have you ever stopped to think how stupid we are in the way we treat the most precious of our possessions—our lives? Too often we wander through life completely evading its responsibilities. George Bernard Shaw said that we seem not to live long enough to take our lives seriously. Your watch is your enemy and you should so regard it. You have so many ticks of this infernal little machine, and then you are gone.

I once read a fascinating article written by Jane O'Reilly and published in *New York* magazine. The article suggests that most people do a random walk through life, moving without getting anywhere. It distinguishes between a career plan and a life plan and contends that the life plan must come first. It suggests that you sit down with a large piece of paper and write down the answers to the following questions:

- What are your lifetime goals?
- How would you like to spend the next five years?
- How would you like to live if you knew you would be dead six months from today?

These questions are designed to help you know yourself. If your answers are truthful, they may prove to be of great interest to you. You will find some of them to be conflicting, and some will prove to be false. They will change from week to week, depending upon your moods, your work loads, and on how well you happen to be getting along with your spouse.

Let me now apply some of these thoughts to the accounting profession. If you despise tax work, yet find yourself wedded to a tax practice, you may be able to overcome your dislike and make it as a tax practitioner. You may, however, develop ulcers and a bad disposition, and if you don't like the work, you will never be an outstanding tax man.

We all have responsibilities and pressures with which we must live. But you can do more with your life than you believe you can. If, by answering these questions you begin to know and understand yourself, you will be able to reconcile and accommodate your goals and characteristics to a rewarding career. You will be able to plan your time and do your tasks in order of priority. Force yourself to include in your planning some time to devote to the good of society and of mankind. And, remember that, in regard to your career and your life's course, the process of introspection is a continuing one. Your goals will change with time, moods, and circumstances.

This entire exercise sounds ponderous. But don't take it too seriously. Have some fun as you go along. I believe that the practice of public accounting can be dynamic, ethical, demanding, and energy-consuming—and still be fun!

Plan for Your Practice

Begin with an evaluation of your present practice. Analyze your firm's strengths and weaknesses and break them down into two categories, internal and external.

Under internal, observe the strengths and weaknesses of your people. Consider your practice as it relates to various types of work (audit, tax, MAS, accounting services) and to the various industries and segments of your business community. Examine the financial strengths and weaknesses of your firm lest you plan for more practice than you can finance.

In the external analysis, consider your size and the geographical areas in which your clientele is located. Make an effort to determine the quality of your reputation.

When making plans, plan for change. A thoroughly worked out plan can be a plan for the destruction of your practice. You may be assured of this terrible result if your plan is based on the following three ideas:

- *Status quo.* Rapid changes are occurring in business, in people, and in our profession. Plan for these changes rather than for the perpetuation of things as they are.
- *Seniority.* The relative advantage of experience over knowledge is disappearing. Plan to utilize the information of young people who have often acquired knowledge which many of us with more experience do not have.
- *Restricted promotional opportunity.* Today people are more mobile and self-assured than they were a few years ago. They want challenge, responsibility and self-fulfillment. If they don't get it, they will leave.

If your practice is to continue to grow in size and quality, you must have the commitment of the people who work with you. Company loyalty in the traditional sense is fading. Not all of the people who are complying with your desires for the future are committed. A personal commitment to achieve the goals and objectives of your practice is a state of mind. It can be developed if your plan is flexible and offers people an opportunity to participate, to be challenged, and to be recognized.

Industry and Government Trends and Activities

In the development of a plan for your practice, examine the industry activities that might affect its ultimate value. Perhaps some of your clients are in businesses which are becoming obsolete. Look for the industries which are growing and for which the future looks bright.

Develop skills which will be of service to these industries so that when the opportunity comes, you will be ready.

Consider government activities and trends which might affect your plan. Government controls and subsidies have a direct effect on specific industries and businesses, as well as on business in general (e.g., consider the effect of Medicare legislation on the health care industry). Read the general economic and industry forecasts and observe the activities of your state and local governments.

The Management of Your Practice

One of the most fascinating things about a career in public accounting is the opportunity it affords to observe businesses—to watch those that grow and prosper and those that fail. I have come to the conclusion that the most important signpost of the future of a company is the quality of its management, particularly the chief executive.

In 1967, *Forbes* made an intensive study of the causes of success and failure of U.S. businesses which were prospering in 1917. Their progress was traced through the years to 1967, including, of course, the 1929 stock market crash, the great depression of the 1930's, and World War II. The study resulted in the following conclusions:

1. Of the top 100 corporations in 1917, only 43 remained among the top 100 in 1967. The others had either failed or declined significantly in importance.
2. The industry involved had almost no influence on the rate of failure or success. (IBM was born during the period of the study and by 1967 had reached the tenth position. Hundreds of other companies producing business machines and information-processing equipment failed during the same period.)

The *Forbes* researchers made the following comment: "If a company has nothing going for it except one thing—good management—it will make the grade. If it has everything except good management, it will flop."

The plan for your practice should include a series of goals, each of which should be a long-range, nonquantified statement of a mission. Having selected your goals—and there shouldn't be many—you may break each one down into its component parts and plan how and when to accomplish it. An example of a set of goals for an accounting practice follows:

1. Decide on the services to be rendered by your firm.
2. Choose methods of performing these services. Such performance is referred to as "production" and includes such things as office facilities, quality control, etc.

3. Establish personnel policies.
4. Institute a program of external relations, including relations with clients (billings and collections, etc.) and relations with nonclients (public relations).
5. Establish an organization plan which includes the development of an administrative structure for the firm.

One of your goals should also be to fulfill your responsibilities to government and society at large. A great firm contributes to the well-being of the society of which it is a part.

To summarize, the plan for your practice should include the recognition of change, and it should be flexible enough to be upgraded often. It should begin with an evaluation of your present practice and should consistently consider industry and government activities and forecasts. It should establish the goals as to what kind of practice you wish to have and how it is to be managed.

The following are specific suggestions for practice development.

Accounting and Auditing

The investment bankers who underwrite securities sometimes suggest that their clients replace a local firm with a national firm to perform the required audit. This practice became so widespread several years ago that the American Institute of CPAs formed a special committee to study displacement of CPA firms. This committee is still active today.

If your firm is not one of the larger firms, don't run and hide if one of your clients plans to go public. Equip your firm to handle such work. Familiarize yourself with regulations of the Securities and Exchange Commission. Study the business problems and opportunities your clients will face if they go public. Learn something about private placements of financing, which sometimes are more advantageous than public issue of securities. Make an effort to become acquainted with some of the investment bankers who might be involved in securities underwritings.

Unaudited financial statements make up a substantial portion of the practice of many CPA firms. Some of your nonopinion engagements should be upgraded to full audits. Many of them include some audit procedures, and, with some persuasion, the client might well see the value of enlarging the scope of the audit.

Some nonopinion work is nothing more than a case of a client's trading on your name. Even though you disclaim an opinion, if your name is associated with a set of financial statements and something goes wrong, your clients will maintain that they placed some reliance on the statements because you prepared them. If you do engage in the practice of associating your name with unaudited financial statements or in write-up work, it is imperative that you protect yourself against a new hazard which has reared its ugly head. I refer to what appears to be the extension of legal liability to accountants in the fields of write-up and nonaudit or limited audit.

In June 1970, a New York trial court found against a CPA firm in a case involving unaudited statements. The case was appealed, and the appellate court upheld the decision of the trial court. It is anticipated that a further appeal will be undertaken. The case I refer to is the case of *1136 Tenants' Corporation* v. *Max Rothenberg & Co.* The defendant CPAs were required to pay the plaintiff a judgment which, with interest and court costs, amounted to $237,278.83. The fee for services rendered by the defendant CPAs was at the rate of $600 per year.

The lessons to be learned are these:

1. Compose an engagement letter for write-up or other nonaudit work. Have a copy signed by the client so that there will be no doubt as to what services you are to perform and what you are not to perform.
2. Write your disclaimer based on the one suggested in Statement on Auditing Standards no. 1, section 516.
3. Read and familiarize yourself with Statements on Auditing Standards

When things go wrong, people sue—and they sue their CPAs. No matter how right you are, a suit costs time and money; it puts grey in your hair, wrinkles your brow, and gives you ulcers.

Bankers are a source of clientele, as we all know. They can assist you in the upgrading and expansion of your practice. If you are persuasive and logical and can work with bank loan officers, you will find that you can upgrade a number of your nonaudit clients, particularly if the prior engagement already involved some audit work.

Sometimes auditors are appointed on the basis of written proposals. If you have the opportunity to give written and oral presentations, do your homework and go all out to make a good presentation. Businesses which select auditors in this way often are sophisticated companies which would help satisfy your desire to upgrade your practice. Prepare your proposal with all the skill you have.

Sometimes, in cases of proposals, the award is based on price. This is a sad fact of life, but the clients who shop for price are not likely to be clients who will upgrade your practice. They are more likely to downgrade it and keep you on the treadmill, trading dollars of payroll and other costs for dollars of revenue.

Tax

The plan for your tax practice should emphasize tax planning and de-emphasize compliance work—the mere grinding out of tax returns. High-volume, low-priced preparation of individual returns should not be part of your practice. On the other hand, preparation of the tax returns at a professional level is, of course, worthwhile.

Your tax practice should involve your skill and ingenuity as a tax planner. I suggest that you examine your list of tax clients, segregate those who are served for a minimal fee, and consider the possibility of increasing both your services and your fee. If you prepare tax returns for a fee so low that you really are not being compensated for your skills as a CPA, consider the possibility of allowing a non-CPA to prepare these returns, so that you may concentrate your energy and skills on better clients.

The development of a tax practice is a long, slow process. It is the result of good performance and the acquisition of new clients through referrals of other satisfied clients. If you have tax clients who engage in questionable practices and cannot be trusted, get rid of them before they get you into trouble. Life is too short to allow for time spent serving reprobates.

Here are some things you can do to expand your tax practice:

1. Hold regular client seminars to discuss the changes in the tax laws and regulations or any new developments.
2. Be prepared to do the tax work for the executives of your audit clients.
3. Get your tax people into the offices of your audit clients to make tax planning reviews and to study the tax provisions proposed for the financial statements.
4. Make sure a tax person is assigned to every audit and management advisory services client.
5. Sponsor sessions with attorneys and bankers to discuss specific tax matters.
6. See to it that members of your firm are active on the platform, giving talks on tax matters.
7. Sharpen your skills in the preparation of financial projections and cash flows in order to assist in tax planning for your clients. (Be sure you abide by the ethics rule on forecasts and disclose the source of information used, the major assumptions made, the character of the work performed, and the degree of responsibility assumed.)

The basic and most important means of upgrading and expanding your tax practice is the constant study of tax laws and regulations by everyone in your firm who has anything to do with taxes. The more knowledgeable you are, the more likely you are to attract and keep good clients.

Management Advisory Services

If you represent a small firm that has no management advisory services practice, start one. In doing so, you might consider some of the following suggestions which are condensed from John L. Carey's book, *The CPA Plans for the Future.*

Begin with a study of each of your clients. Look for problems in planning, control and decision-making. Look for needs for cash forecasts and for the study of product lines. Examine buy-or-lease decisions, break-even points, acquisitions of other companies, and budgeting. Having found the problems, study them and discuss them with your client. And, presto! you may have a management advisory services engagement.

I have addressed these remarks about management advisory services to those who have no MAS practice, but they also apply to those who do. Study your clients, as I have suggested. Follow my simple directions and, lo and behold!, you will have expanded your MAS practice.

The demand by American businesses, both large and small, for competent advice and consultation has not been measured, but it would appear to be nearly unlimited. Taking full advantage of this opportunity will require special organizing and planning on your part. I have a few suggestions.

1. If you haven't named someone to head your MAS activity, do so. Look over your young, bright audit staff to find someone who is innovative and successful in accounting and auditing and interested in accounting as a tool of management. If he is interested in leading the MAS function, give him the responsibility.
2. Develop an MAS plan which considers—
   - A training program for your newly appointed leader.
   - A business development plan with specific goals.
   - A plan to broaden your MAS skills to include at least EDP and basic organizational planning as well as accounting and financial planning.
3. Get your MAS personnel involved in the activities of the state society, AICPA, and other professional organizations.
4. Inform your clients, your partners, and your staff that you are officially in the MAS field. Encourage your associates to promote this area of the practice to existing clientele. Let them know that their participation in its development is a major part of their responsibility and a key factor in your appraisal of their performance.

Conclusions

I have outlined some thoughts about planning and have suggested methods of upgrading and expanding a practice. Here is a list of reading materials which I consider important and which have served as a basis for my own thoughts on these subjects:

1. *Managing for Results, The Effective Executive* and *The Age of Discontinuity,* by Peter Drucker.
2. *Journal of Accountancy.*
3. *The CPA Plans for the Future* and *The Rise of the Accounting Profession,* by John L. Carey.
4. The Statements on Auditing Standards published by the AICPA.
5. Opinions of the Accounting Principles Board, statements of the Financial Accounting Standards Board, the research studies and other literature of the AICPA.

At the meeting of Council of the AICPA in May 1972, Frank Wheat made a comment which will set the stage for a plea which I would like to make. Mr. Wheat is an eminent attorney and devoted friend of the accounting profession. He served as chairman of the Study on Establishment of Accounting Principles and as a commissioner of the Securities and Exchange Commission. He told Council:

"I would make one comment as a detached and sympathetic observer. Public accounting for many has become big business. Can it survive, both as big business and as a profession? It can, I believe, but only if it gives its support in full measure to the task of establishing standards of reporting in the public interest, and to the standards themselves, when adopted."

The mention of accounting as big business made me pause. Although I have discussed and suggested methods of attracting engagements, I do not wish to emphasize the business aspects of our profession to the point of de-emphasizing the professional aspects.

I believe professional people have a special niche in life. And I believe we CPAs are fortunate to have chosen the profession we have. It is a respected profession, a unique and rewarding profession. We have major ethical responsibilities, but we also have freedoms of choice in the development and in the nature of our work which nonprofessionals do not have. In your zeal to organize, don't allow your practice to become a highly structured business machine. In your zeal to grow, don't degrade your professional standing, because it is essential to the highest qualities of growth.

Journal of Accountancy, *August 1977*

Long-Range Planning for a Local Firm

Raymond Telling

Long-range planning is one of those subjects that many administrative partners think is a good idea, but somehow they never get around to doing much more about it than setting out the philosophy of the firm, agreeing possibly among the principals as to what the goals should be, and maybe going as far as projecting income and expenses for the next year or two. But as for making a financial plan in reasonable depth for the next five years, not many do it.

Putting the goals of the firm in writing is extremely important, but if it isn't backed up by a financial plan, it has about as much validity as a political platform developed at one of the party conventions. It sounds great but no one takes it too seriously.

Pros and Cons

The *Management of an Accounting Practice Handbook* doesn't go very deeply into the techniques of long-range financial planning. The comments in the handbook can be briefly summarized by listing the following pros and cons:

Cons

- Conditions fluctuate too much to make ordinary budgeting practicable.
- The derived benefits do not compensate for the time consumed in constructing the budget.
- Large unexpected fees can distort revenue estimates.
- It is difficult to predict staff salaries because the need for additional staff members cannot be predicted without a better long-term knowledge of how audit engagements will flow.
- Previous attempts at budgeting have not demonstrated its value.

Pros

- Such planning can determine whether estimated income is satisfactory in relation to estimated costs.
- It guides the firm in scheduling or deferring special additional expenses.
- It indicates whether the overall fee structure is satisfactory in relation to costs, or whether adjustments are needed.
- It permits the firm to estimate the amount of time remaining for special work by comparing available time for the current year with the service time for regular clients of the previous year. It also aids in planning for the timely hiring and training of new staff members.

My philosophy of long-range planning goes well beyond the above pros. This is no doubt greatly influenced by my business career, which includes 15 years spent in industry, as well as those in public accounting.

Once or twice a year, when I was part of management of a Wisconsin corporation, we would select a small team and go away to a club in Chicago to hammer out our specific goals, plans, etc. There was a lot of give-and-take in these meetings. We were all busy with other duties back at the office but getting away was the trick. It sounds expensive—in the long run it's really cheap. We never had more than four people at any meeting—usually only three. That to me is important.

I believe that a large part of our business success was due to long-range planning, reducing this plan to writing, and making a financial projection. It completely changed the character of the business, our marketing, product, and financial strategy—all for the better.

Later when I returned to public accounting, it seemed only natural to carry many of the ideas proven in industry into the management of a public accounting firm. Admittedly, there are some problems in financial planning for a public accounting firm that are not found in business, but frankly, they're minimal.

It surprised me to discover that one of the greatest advantages for long-range financial planning is found in accountants themselves. Let's face it—we're different. Previously I had been dealing with sales managers, marketing people, personnel managers, manufacturing vice presidents, etc. Now I was dealing with accountants only. One thing about most accountants is that we like to see things on work sheets and we can relate to a pro forma profit-and-loss statement or balance sheet. Sales managers aren't built that way.

Most of the MAP conferences I had attended sooner or later got around to questions such as "How do we handle this partner?" or "How do we keep our brilliant young accountant?" To an amazing degree the goals of many partners or staff seem quite far apart. This causes so many difficulties that every year we have MAP conferences on basically the same old problems.

Reducing a five-year plan to figures enables accountants to see where they fit into the picture and how they are going to obtain their goals. These figures allow us to determine whether or not we can afford to retire this employee on X number of dollars, purchase another practice, buy the computer, and still pay the brilliant young accountant the money he or she wants. It has enabled us to specifically thrash out or talk over many of these problems and put them into dollars and cents.

It does something else too. It helps create the feeling of an entity rather than a collection of individual professionals loosely gathered together in some sort of organization. To me that is one of the major faults of many present-day partnerships. They are like the original 13 states before the Constitution. Many never get a constitution to work by, but they all have their share of senators.

Developing Your Marketing Strategy

I believe the place to start a long-range plan is with a projection of income—or in business terminology "developing the marketing strategy." If a firm is starting to put a long-range plan into writing, it should concentrate first on income growth. And that is all it should concentrate on at its first meeting. Each partner or other group member should write down the strengths and objectives of the firm, the fee-growth goals, the amount of income needed, and the growth plan to achieve this income.

Many of the thoughts of this article are taken from the noted author and economist Peter Drucker, who has stated that the best way to come to grips with one's own business knowledge is to look at the things the firm has done well and the things it apparently does poorly. This is particularly revealing if other equally well-managed firms have had an opposite experience in similar undertakings. "What have we done well and without any sense of strain that somebody else has failed to do?" is thus the first question. And, "What do we do poorly that someone else seems to have no difficulty with?" is the corollary. Some of the most successful accounting firms (from the outsider's viewpoint) seem to specialize in a few areas. They get an expertise in one area or two, including—perhaps most importantly—marketing expertise. Other firms get along, again apparently quite well, by being all things to all people. When I got back into public accounting, many people told me to move out of write-up work, but our write-ups on a computer have proved satisfactory.

I don't think I can emphasize enough the development of a marketing goal.

Billing Projections

The first schedule I developed was a billing projection (Chart A) for a five-year period by type of services—auditing, taxes, MAS, write-up, etc. The strategy that the model firm developed showed an increase in auditing work with a decrease in income tax preparation and unaudited statements. Since write-ups and write-downs are so important, the firm planned to decrease the write-downs. The schedule looks simple but there is a lot of eraser use here—a lot of real thinking. One of the big questions to be answered in any growth plan concerns acquisitions.

As to acquisitions, these are the basic criteria our firm has used to enable us to meet our goals:

- The acquisition or merger must be concluded on a basis whereby our firm maintains effective control of the combined operation. (One of the reasons we became a professional corporation was to facilitate this.)
- The cost of one or a combination of acquisitions in any five-year period will be consistent with the firm's financial resources and planning.
- There must be capable professionals and professional managers willing to remain with the acquired firm if it is in another city.
- The acquisition should offer a reasonable expectation to return our firm a minimum of 15 percent on its investment within a two-year period.
- The opportunity should offer a minimum growth rate potential of 10 percent per year.
- The acquisition candidate must have a reputation for high quality and professional work or we should be able to transplant that high quality in a very short time.

No matter how well-ordered a business or professional firm, there is always much more to be done than resources available to do it. There have to be priority decisions or the right things won't get done. In these priority decisions a professional firm expresses its final appraisal of all it knows about itself, its economic characteristics, its strengths and weaknesses, and its opportunities and needs. Making priority decisions forces a firm to convert good intentions into commitments. Nobody seems to have much difficulty setting priorities. What people find difficult is deciding what should not be done. It cannot be said often enough that one does not postpone projects, one abandons projects.

Long-range planning list of charts and schedules (five-year period)

Billing projection	Chart A
Personnel projection	Chart B
Number of persons with fee projection	Chart C
Income statement	Chart D
Profit contribution of increased billings	Chart E
Facilities plan	Chart F
Pro forma balance sheet	Chart G
Projected cash flow statement	Chart H

Taken from *MAP Handbook*—for firms A and B

- Organization charts
- Balance sheets and income statements
- Control statistics
- Analysis of standard and net fees
- Analysis of certain operating expenses
- Preliminary one-year summary forecast
- Final one-year summary forecast
- One-year forecast by months of income and expense
- One-year forecast by months of audit staff
- Test of work force requirements—audit staff
- Office layout—square feet required for various types of areas

Personnel Projections

After the income growth plan is decided on, the personnel and organizational structure of the firm must be developed and coordinated. The next step is the development of plans for accomplishment of the desired growth and increased efficiency of the firm's human resources.

We have developed personnel charts to be used, not necessarily as some special type of individual performance evaluation, but as a working tool for management in determining possibilities for promotion, depth in various positions, etc. In our firm's planning meetings, we don't carry any of our personnel files with us, but rather find these charts more meaningful for planning.

Based on the billing projection that was prepared first, the long-range planner should now develop the personnel projection (Chart B). This chart is essentially a projection of the personnel over a five-year period with their related annual compensation costs. I haven't taken inflation into effect in these model charts, but I do when I work on the plan for our firm. I also plan a factor for wage increases.

Individual Fee Projections

Prepared concurrently with Chart B are the desired individual fee projections (Chart C). There are work sheets in the *MAP Handbook* which help you to calculate the billings per person for a year and to convert from annual compensation to net fees. I've tried to tie in these long-range planning forms with the work sheets in the *MAP Handbook.* When I prepared the data for our own firm the first time it worked quite well.

Projected Income Statements

By forecasting the remaining expenses (rent, depreciation, etc.) we complete a projected income statement (Chart D).

After the income statement has been prepared it only takes a short time to prepare the profit contribution of increased billings (Chart E). This chart helps me determine the direction our increased expenses are taking each year.

Facilities Planning

The *MAP Handbook* has a section on office layout, including square footage for types of offices, etc. By using the data in the handbook and the personnel projection for the five-year period, it is a simple matter to prepare the facilities planning chart (Chart F).

We won't get into the complexities of renting vs. building here. The facilities plan can really become complex—location, remodeling or modification of present facilities, future growth requirements, parking, etc. Considerations of space don't allow me to get into all the facts that could be considered. Perhaps you would want to examine alternative plans, for instance, renting or building more space than you now need, then subletting.

Pro Forma Balance Sheets and Cash Flow Statements

The preparation of a pro forma balance sheet (Chart G) and cash flow statement (Chart H) should not be just mechanical. Simultaneously with their preparation and in order to ensure that the company's long-range operational plans result in profitable growth and a sound future financial condition, a long-range financial plan is developed. The basic objectives of this plan are to determine—

- The financial feasibility and consequences of the company's long-range operational plan.
- The extent of the company's financial capacity for future acquisitions.
- The extent of the company's financial capacity to pay for deferred compensation agreements, partner pay-outs, etc.

Conclusion

After the long-range plan has been put together, a two- or three-page summary of conclusions and a management action plan should be put in writing. We distribute this written communication to key members of the firm below the partnership or officer level.

To build professional performance into a human organization is difficult but essential. A firm, after all, does not have a program for performance. Its managing officers or partners must have such a program, work it out, formulate it, and make it effective. Economic results are not produced by economic forces; they are a human achievement.

Journal of Accountancy, *October 1972*

Practice Development— The Forgotten Client

Robert K. Whipple

Have you ever heard a practitioner complain about low fees, inadequate staff, and having to work long hours? Or express dissatisfaction with the nature of client assignments? Does this strike close to home? Most of us, at one time or another, have suffered from some, if not all, of these complaints.

I believe all of these problems are interrelated—each to some degree is the result of the others. Low fees do not provide adequate income to pay competitive salaries for competent personnel. And lack of competent personnel not only limits the type of engagements we can undertake, but also affects the quality of service, which in turn influences the level of fees we can expect. The firm has to work longer and longer hours to obtain an adequate income and the pressure of more and more work usually lowers the quality of the engagement the firm is willing to accept. On and on it goes with no apparent way out.

Most practice units have a forgotten and neglected client who can provide the way out of this dilemma. This is the person or persons who own and operate their own businesses. Yet, in most cases the nature of work performed for this owner/manager client is limited to one or more of the following: write-ups, financial statements, tax returns.

It is not unusual for this type of client to describe his accountant as a necessary evil imposed upon him by the complexities of government regulations, bankers, and bonding companies. He relates his accounting fee as part of his tax cost, interest expense, or insurance cost. With this attitude, is it any wonder he looks for the lowest fee and generally lacks an appreciation of the accountant's role? How frequently we hear the practicing public accountant criticize his client for not using or understanding the accounting information given him. "He never looks at the financial statement" or "He only looks at the bottom line" are frequent laments. How many of us have ever stopped and asked ourselves if the information we are furnishing these operating managers *is* really useful? Have we ever taken the time to counsel and work with these people on how this information can be used in the day-to-day operation of their businesses? Is our end product the preparation of financial information or the use of it?

In these situations we have not clearly identified who our client really is—the owner as the operating manager. We are providing a service oriented to the third-party public (absentee ownership, government, bankers, etc.) and have neglected the needs and wants of the operating manager. Unfortunately, most accountants have not recognized that operating management has entirely different information requirements from those of the third-party public.

Most of our formal education in accounting and most of the attention of our professional organizations are directed toward the requirements of third parties. We have been taught how to record and summarize historical financial information, prepare balance sheets and income statements, and prepare tax returns—none of which has much use for the day-to-day decision-maker trying to operate a profitable business. We have been trained to prepare information for the general use of the third-party public and yet many of our customers are the first-party day-to-day managers of business. No wonder so many of our clients regard us as a necessary evil imposed upon them by outsiders.

Is it not obvious then why so many of our clients are disinterested in our work, unappreciative of the information we give them, feel it has a minimum monetary value to them, and are constantly pressuring us to present the historical record in the way they think best?

Providing Operating Managements With What They Need and Want

I don't want to imply that we should abandon our role as auditors as well as preparers of financial statements and tax returns. This is an important part of our practice and will continue to be so. However, I firmly believe the key to practice development and upgrading is to provide *operating* managements with what *they* need and want. We must learn to communicate in *their* game using *their* terms. We must learn to identify the information *they* need on a daily basis to make operating decisions.

Let's turn our attention to some practical ways in which we can develop this neglected client. First, find out what information he is using in his daily decision-making. Ask him to open his top right-hand desk drawer and show you the report he gets each day. Find out the "rules of thumb" and other ways he has to measure performance. Don't be surprised if some of this information is in quantitative terms rather than dollars. The dollar is not a common denominator to operating management.

Once we find out what he is using we should look for an area where we can suggest a faster way to get the information, an easier way (more economical), or a more accurate way. We will see quickly how our training and experience can be easily adapted to this type of situation. We shouldn't overwhelm him with too large a project or too big a change at first. We should pick out something that can be easily and quickly accomplished.

We've all been rebuffed by a client for trying to sell a budget system, new accounting system, or cost study. This is probably because of the lack of experience in selling this type of service. Generally, we must have operating management's confidence before we can move into these major projects.

As soon as we begin to talk to operating managements about *their* problems, we will find an immediate change in attitude. All of a sudden they will be talking about how *their* accountant is interested in *their* business. They will start thinking of you as part of *their* management teams. They will no longer be looking upon you as a necessary evil, but instead as a valuable member of *their* operations.

Getting the Client Out of the Past and Into the Future

The next step is to get the client out of the past and into the future. Successful managers are less concerned with what has happened than with what is going to happen and how they can affect it. Both the CPA firm and the client need to become fortune tellers, not historians. It is inevitable that we will be moving into the following types of services—budgeting, cash forecasts, working capital forecasts, manpower needs, inventory controls, cash controls, feasibility studies, and alternative choices. We will not have to sell these services to our client—he will be demanding them.

Remember, I mentioned earlier that I was not suggesting throwing out the things we are presently doing—the traditional services. I only suggest this as an additional way to develop a more profitable, interesting practice.

Too many CPA firms are where they are today not because of their direction and leadership but because of who called on the phone and what service the firm was asked to perform. If we are not to just drift in the stream going wherever the current carries us (write-up work, tax returns, financial statements, consulting, etc.) we must have firm objectives regarding the nature of the practice we want to develop. And if the decision is made to expand into the area of management advisory services, a firm might consider the following procedures to get itself started:

1. Work toward getting existing clients to do more of their daily recordkeeping internally. Develop their capabilities. Get involved with operating management as mentioned earlier to replace the write-up and financial statement work.
2. Take on new clients only if they desire or are potentially suited for the type of service the firm wants to provide.
3. As new clients compatible with the firm's objectives are developed, begin to cull out existing clients who are not going to be compatible with these objectives.
4. In talking with existing or prospective clients, emphasize professional ability to help them use financial information for more profitable, efficient operations.

As a firm moves more and more into consultation-oriented assignments with operating management, it will notice several changes. First it will have less trouble with fees. Clients will accept higher fees since they are now in a better position to evaluate services rendered. Morale will improve because the staff will spend more time on interesting and challenging assignments that, when performed well, will result in greater client appreciation. Also, the nature of the assignments and the new fee structure should permit the firm to hire top-level staff people.

In summary, transferring an accounting firm from "product-oriented" to "service-oriented" and from "historians" to "fortune tellers" should change the characteristics of the firm. Fixed fees will be a thing of the past. Varying services will result in varying fees that will be easier to adjust and justify. Also, higher fees will be more acceptable to the client because the CPA firm will be doing work that he understands and appreciates and is of value to him in the day-to-day operation of his business.

Journal of Accountancy, *February 1978*

Year-Round Practice Development

Norman S. Rachlin

Many local practitioners tend to find an excessive workload in the months of January through April and not enough workload in the other eight months to keep personnel productive at a high level.

This extreme workload variation can lead to other problems, such as poor scheduling of engagements, erratic production, reports delivered late, and an excessive number of tax return extensions. Through its effects on client service and staff turnover, poor handling of workload variation can lead to a firm's decline and perhaps its eventual demise. A year-round practice development program, directed at leveling off the workload (at a high level, of course) can help avoid such problems. The goal of such a program is to make those "other eight months" more productive and enable the firm to obtain and retain qualified personnel.

Instead of fighting the calendar, the practitioner should turn it to his advantage by means of the following steps: List all services which your firm has available during those "other eight months" and communicate this information to your clients. Also, involve your professional staff in the implementation of these services. A typical list might include tax planning services such as retirement plans, income allocations, timing, tax shelters, reorganizations, liquidations, exchange of property, 1244 stock, subchapter-S corporation, medical reimbursement, income averaging, loss carrybacks, and depreciation methods.

In the estate planning area, the list might include estate tax projections, trusts, gifts, probate and administration expenses, assistance in will preparation, and estate planning questionnaires. As to financial planning, services might cover budgets, projections, bank loans, other borrowings, stock sales, investments, refinancing, and personal financial statements. In the business counseling area, coverage might include short- and long-range plans, buy-sell agreements, recapitalization, change of fiscal year, insurance programs, accounting manuals, recordkeeping systems, litigation assistance, mergers and acquisitions and adding partners, stockholders, or other investors.

This is meant only as a guide. Each firm, of course, could develop its own list suited to the abilities and background of personnel and to individual capabilities.

Develop Firm Specialties

In addition to some of the more common off-season projects (like estate planning, change of year, or budgeting), you might develop industry specialities which require services on a year-round basis. Some well-known ones include services for professionals (attorneys, doctors, dentists, veterinarians, architects, real estate brokers, etc.), construction and land development, banking and/or savings and loan associations, health care services, retailing, garment manufacturing, auto dealerships, hotels and motels, restaurants, utilities, mobile home parks, and municipalities.

For a more comprehensive listing, consult the standard industry codes (SIC) used by the Treasury Department in tax return classification. Also, your list of clients should provide clues as to an industry or industries suitable for specialization within your firm.

"Exotic" Specialties

Some firms, through a unique circumstance of geography, engagement experience, client requirements or personnel talents, may venture into other specialties. These include investment counseling, data processing services, foreign taxation, acquisition and mergers, legal support services, and cost accounting. In fact, some of the areas could provide specialty business in combination with others. Estate planning, for example, might include trusts, gifts, assistance in will preparation, and the like.

A note of caution, however. Before a firm announces a specialty, it must first make a commitment in resources (time, personnel, and money) to develop the specialty. Development includes a philosophy, scope of services, forms, samples, checklists, market analysis, selection and training of personnel, testing, and communications planning.

Communicate Your Services

A firm may have a competent estate planning department but if clients and potential clients don't know about it, they will not seek its services. There are a number of ways to communicate these available services in keeping with the high standards of the profession.

Fiscal Year-End Conferences

As a rule, we do not mail fiscal year-end financial reports and tax returns to clients. We invite them to our office to meet with the partner-in-charge, the senior staff person on the job, and an appropriate firm specialist (depending on particular client needs). Having the meeting in our office accomplishes two objectives:

1. We have the client's undivided attention.
2. He develops more confidence in us as an organization capable of fulfilling all his needs on a continuing basis.

At the meeting, we review the completed fiscal year and discuss plans for the new year. These plans include financial and business planning as well as tax planning, and are directed to the individual owners as much as to the company. During the meeting, items previously enumerated can be introduced at appropriate times.

Important note: Do your homework before and after the meeting. Have your own internal pre-meeting so that you are all on the same wavelength as to the direction of the meeting. Prepare an agenda. Have the staff person keep minutes. After the minutes are approved by the partner-in-charge, they should be typed and distributed to all participants of the meeting. The minutes should set forth proposals adopted, person responsible for each, and target dates.

Regular Interim Meetings

Depending on the type and complexity of the client's activities, interim meetings should be conducted in the same manner as fiscal year-end meetings. Some clients may require monthly or quarterly meetings, but certainly most should have the minimum of a tax planning pre-fiscal year-end conference. Again, agenda and minutes are important. They are not only a professional and efficient way to conduct a practice, but are also responsive to the direct (or sometimes implied) question, "What have you done for me lately?"

Partners in our firm keep copies of these agenda and minutes filed in a notebook along with copies of the client's financial reports.

1040 Time

An excellent time to develop "off season" activity is during "the season" itself. This is an obvious time to bring up such subjects as estate taxes, tax-sheltered investments, Keogh or IRA plans, incorporating a business, and other tax planning ideas. It is opportune because the client is now directly faced with his annual income tax bill. However, this is also your busiest time, and it is most difficult (if not impossible) for you to act immediately on these valuable suggestions.

We have developed a form to capture the client's interest in special services and defer the services to the "other eight months." The form is completed by the interviewer when preparing the 1040 and by the reviewer, who may spot other opportunities as he checks the return.

Reviewing Business Returns

When reviewing a business tax return, you should go beyond merely checking computations and doing obvious work such as matching inventories in the cost of goods schedule to inventories listed on the balance sheet. These are necessary, but will not enable you to provide your client with other needed services. You should also prepare a comprehensive list of tax review items. Include such positive ideas as inventory methods, depreciation alternatives, pension plans, medical reimbursement plans, fiscal year change, reorganizations, stock dividends and other possible tax planning concepts. Personnel who prepare and review the returns should check those items which may be applicable to the particular client.

After checking tax review items, you may wish to send a personalized "tax management" letter to the client. A sample letter appears below:

> Dear client:
>
> Upon completion of your current fiscal year-end tax return, it came to our attention that the following tax planning suggestions might be worth your consideration:
>
> *(The items would then be listed from those checked on the planning checklist.)*
>
> We would be pleased to review these matters with you as to potential tax deferrals or savings. A call to ____________ at ____________ (or to any partner or member of our tax department) would provide for discussion of these potential tax planning areas.
>
> Very truly yours,
>
> Signature

Business Seminars

Seminars are an excellent way to notify clients of your expertise while providing them with additional valuable services. We conduct an annual update in one of our specialized areas, and it is well attended by clients, attorneys and others who are interested in this field. We send out fliers to our clients, with a response coupon in the same fashion as is done for a state society or AICPA professional education program. The event is also publicized in our firm's newsletter. Other areas which client seminars may cover include year-end tax planning, estate planning, and the current investment market. In the area of personnel management, topics include how to keep records, payroll taxes, and recordkeeping in a medical office. Seminars appropriate for your practice and your community should be developed.

Speeches and Articles

Previously mentioned specialty areas can be covered in speeches and articles by members of your firm. They require about "1% inspiration and 99% perspiration," a little common sense, and a lot of preparation, but they are worth the effort.

Start small (speaking to the local Lions Club, for example) and work your way up (addressing a national industrial convention). Offer to write articles for the local newspaper or a trade journal. Get to know the personnel of the trade association of your industry specialization. You have something worthwhile to communicate. Put your knowledge to effective use.

Brochures

A brochure, prepared for you by communications professionals, should be in good taste and in conformity with professional ethics. It can effectively communicate both the traditional and special services offered by your firm. The brochure should present a brief history of the firm and its philosophy, and mention traditional services in the areas of accounting and auditing, taxes, and management advisory services. In addition, it may describe the firm's industry experience and other specialized services.

It is suggested that the brochure be flexible enough to fit specific clients or purposes and to accommodate changes in staff, services, reprints, the firm's newsletter, and commendation items, etc. A cover letter addressed to the recipient should be included with the brochure.

Newsletter

Your monthly newsletter may be effectively used to communicate year-round the services you offer to clients. A calendar of due dates provides a useful checklist for clients. Articles on such subjects as payroll reports, refinancing, credit data and tax shelters help pinpoint the firm's supplemental services during times when they are most needed.

Other mailings

1. 1040-ES vouchers. When a 1040 is prepared, we retain the 1040-ES vouchers 2, 3, and 4. This gives us three opportunities during the year to communicate with clients whom we would nor-

mally see only once a year. About three weeks before a voucher is due, we send it to the client along with an insert which contains instructions for filing an estimated tax and the due date, an invitation to discuss amending the current voucher if changes must be made, and other general tax hints.

2. Specific tax tips to specific clients. If an item comes to our firm from a tax service, newspaper, or other source which relates, for example, to component depreciation for apartment buildings, a copy (with a personal letter) is forwarded to clients who own apartment buildings. This not only informs such clients that we are alert to new developments in their field, but also tells them that we care about them.
3. Telephone advice. Telephone advice should always be confirmed in writing. This indicates that your firm has acted professionally. It removes confusion or doubt as to what the advice dispensed meant, and records the additional services your firm has rendered to the client.
4. Published articles. As previously noted, you should make speeches and write articles.

If you have delivered a talk or had an article published, don't keep it a secret. Let your clients know about it. Such articles can be reprinted and mailed to clients in specific businesses and professions; offered to interested parties via a firm's newsletter; and used in presentations to prospective clients, if appropriate. These articles and the firm's newsletter should also be made available for reading in office reception areas.

Staff Participation

The partners of a firm must recognize that they cannot do a year-round practice development program by themselves and are therefore dependent upon staff members who have direct contact with the client and the client's personnel. Future partners must be trained in the "partnership arts" if the firm is to retain continuity. Staff participation can be accomplished as follows:

1. Include practice development concepts as part of staff training programs.
2. Encourage professional personnel to bring clients into the firm.
3. Senior staff members should attend meetings with clients to learn by observing partners in action.
4. Also, senior staff personnel should routinely receive copies of letters and memoranda sent to clients they service.

5. Communicate about the firm's services to all firm personnel. One of our firm's best in-house seminars focuses on "Services of the Firm"; department heads and other specialists in the firm detail their expertise on special services their department renders. All personnel, particularly relatively new ones, find this program valuable.
6. Remind personnel to read the firm's newsletter promptly so they can answer questions asked by clients about current articles. Also, an alert staff member can direct a client's attention to a pertinent article. And it will help staff people learn more about the firm and about new and important technical items.

Summary

A CPA firm has much to offer its clients. These services can be developed and performed during times other than during the peak tax filing period. When a firm keeps busy all year, it retains capable and motivated staff personnel and it will have a profitable practice.

Management specialist Peter Drucker has said, "A plan is only a plan until it degenerates into work." Developing and implementing a year-round practice development program does require work. But it should be evident the results are worth the effort.

Use of Controls in an Accounting Firm

Carl S. Chilton, Jr.

Proper controls are a cornerstone in the management of any organization. Accountants understand the need for controls, and recommend them to clients. Why then do we read or hear so little about the use of controls in an accounting firm? This is not due to any lack of interest in the subject, or in failure to utilize controls. Certainly larger and medium-sized firms have learned to apply various procedures in controlling their organizations—otherwise they would not have grown to their present sizes.

On the other hand, many firms could probably improve their present systems of controls. They may have too many controls, or too few, or the wrong ones. They could probably benefit from ideas that have worked for others.

This article briefly discusses a variety of controls basic to the successful management of an accounting firm. The procedures described are practical steps that may help you evaluate the performance of people against previously determined goals. They are designed to enable management to keep its finger on the pulse of the firm's activities and to know what is going on without spending excessive time on details.

Need for Effective Management Authority

For a system of controls to work effectively, the firm must have designated management authority. This is usually a managing partner, but occasionally this function is structured in some other form—such as an executive committee. Whatever the form, there must be sufficient authority to see that procedures are established, targets are set, and results monitored. Management must take the lead in motivating, planning, and controlling.

The type of management that functions best in an environment of partners and professional staff is one that provides leadership without being authoritarian. A respected leader can set goals and expect top performance without squelching individuality and creativity. This positive approach to dealing with others paves the way for the development of an enthusiastic and motivated staff.

Effective management and effective controls go hand in hand. Controls won't work without management authority. At the same time, good management will insist on effective controls and can't do its job without them.

Controls on Partner Performance

The partners are key people and the firm's success hinges on their performance. Certainly this is an important area for controls. It is recognized that the higher up a partner moves, especially in a larger firm, the more general his duties become and the more difficult it is to establish controls on his individual performance. His performance may have to be judged primarily by the performance of the people under him.

There are, however, certain areas of responsibility common to most partners which can be measured. Some of these areas and their appropriate controls are discussed below.

Scheduling of Time

A system of scheduling each partner's time on a weekly basis is a useful tool. It requires the partner to improve his activities planning and it provides that the partners and the staff communicate about where they will be and what they will be doing. The partners become more aware of the types of clients and problems dealt with by others in the firm. Such a system can be quite simple to operate, with each partner preparing a weekly schedule and turning it in to a designated person, who summarizes it on a master schedule. These schedules need not be in great detail, but should provide a general description of each partner's plans for the week.

Measurement of Client Responsibility

In most cases a partner's value to the firm is related to the amount of client responsibility he carries. One measurement of this responsibility (but not the only one) is the volume of billings produced by clients for which he is responsible. A report of the monthly and year-to-date volume of billings of each partner's clients is a valuable control tool. It highlights performance in this important area and motivates everyone to better results.

Profitability of Client Billings

A factor that goes hand in hand with the volume of client billings is the profitability of those billings. Here again, a report reflecting net writedowns and writeups by the partner on a monthly and year-to-date basis provides control. It makes each partner's performance more visible and obviously helps keep everyone on his or her toes.

Chargeable Hours and Fees Produced

An important method of controlling partner performance is to establish targets for chargeable hours and fee production. A monthly reporting system compares actual results with the target for the month and year to date. Obviously, there is great variety in partner responsibilities, which affects fee production, but this can be considered in setting the targets. The objective is to control utilization of a partner's time—to ensure that his chargeable hours and fee production are reasonable relative to his other responsibilities.

Production Controls

Controls over the production efforts of the firm's staff are essential. Fortunately, this area lends itself to the establishment of control procedures, and normally any firm with a staff of a half dozen or more will develop some type of system. There are several facets to production controls.

Scheduling of Staff Assignments

The system for this will vary greatly between firms of different sizes, but the objectives are the same for all; to keep idle time at a minimum, to keep jobs moving on schedule, and to put the person with the proper level and type of experience in the right assignment.

In regard to designing the system, use a rule that should apply to a systems job for a client; keep it as simple as possible. Certainly it has to be adequate to meet the needs, but avoid the temptation to make it too complex.

Controlling the Individual Job

Some firms don't do well in this area. It's easy to send employees out on an audit and let them hammer away until it's finished. Then comes the day of reckoning; the hours are up over last year's and billing rates are up, too. How do you explain the higher fee to the client?

There are a couple of well-known techniques that will avoid this problem. First, prepare a time budget on the audit. This subject is adequately discussed in accounting literature, and forms used by other firms are available. The main requirement is to employ enough self-discipline to prepare the budget. After all, a time budget is simply part of planning the job.

Then prepare a weekly report recording time accumulated on the job. This puts the partner-in-charge on notice in time to do something, while a monthly report may be too late.

The proper use of these two techniques can do a great deal to help eliminate costly overruns on jobs.

Analysis of Performance

Performance of staff accountants can be analyzed in terms of chargeable hours and fees produced. A monthly and year-to-date report should be prepared showing the performance of each person. Preferably, this should be compared with previous targets. Also consider providing these reports to staff members themselves—if not to everyone, at least to those in supervisory positions. In some firms incentive programs are tied to these production reports.

Expense Controls

The control of expenses in an accounting firm is no different from that of any other business. The preparation of an annual expense budget is simply good planning that will benefit the firm. Certainly there should be no problem in doing it; it shouldn't be difficult to find an expert close at hand. It simply requires the self-discipline to do a systematic job of planning.

If the firm has targets for chargeable hours and billed production and has prepared an expense budget, the profit target for the year is set. This gives the partners a goal and lets them know what to expect.

An added advantage is that the firm is using its own product—accounting techniques that help in planning and controlling the business. Accountants need not be like the lawyer without a will or the shoemaker without shoes. If we use our knowledge and experience in our own business, we can then better employ such expertise for clients. To say the least, we can better convince our clients of our skills if we are sold enough on their value for ourselves.

Controls Over Collection of Fees

It's nice to bill and it's even nicer to collect. Profitable billings are of no value if a check doesn't follow. It's necessary, therefore, to have controls that ensure a follow-up on collection of fees.

Proper Advance Arrangements With the Client

The best way to ensure fee collection is to make sure that the client knows in advance what he is getting into. If he knows what to expect, he won't be surprised when the bill arrives. The proper use of engagement letters will facilitate these arrangements. If any unforeseen problems that might raise the estimated fee come up while the work is under way, the client should be advised immediately.

Accounting and Reporting on Accounts Receivable

It goes without saying that the accounts receivable ledger should be balanced against a control account, and an aged trial balance—which breaks down the accounts receivable into several time groups such as 30, 60, and 90 days or over—should be prepared monthly.

Proper Follow-up on Slow Paying Accounts

This is a tough chore for many people. It's easy to procrastinate, especially if you're aware of the client's problems. There also may be a concern about disturbing the client's relationship with the firm.

On the other hand, the accountant knows better than anyone else if the client can afford to pay. A reasonable client should not be offended by a tactful request for a payment. This is an area where many practitioners need to develop some skills.

The firm should adopt collection-procedure policies which specify that money must be received before work is performed. Such procedures should be clearly spelled out in writing. The responsible partner can then cite these policies when approaching the client.

Control of Practice Development Activities

Practice development activities are important but are planned and controlled by relatively few firms. These activities don't readily lend themselves to formulation of a plan of action and a followup reporting system. Each partner usually runs into new business opportunities on a hit or miss basis through his individual community activities, personal contacts, and the like.

However, some firms have set up practice development programs on the theory that an organized effort produces better results. These programs attempt to channel the practice development activities into specific areas; partners are expected to consciously try to keep in touch with individuals who can help the firm grow (including that most important group, present clients). These programs provide for periodic reports. Some typical reports would focus on new clients, lost clients, keeping up contacts with clients or referral sources (lawyers, bankers, etc.), and community activities.

While an extensive formal program may not be feasible for everyone, a limited program can be used (reports of new clients and lost clients prepared annually, for example). If nothing else, this program improves communications between partners, who may wish to discuss such matters as lost clients, referral contacts, and the like.

Conclusion

As the firm grows, the need arises for planning and controlling the operation. As has been stated often before, the practitioner tends to concentrate on client work and to neglect important management needs. If sufficient time is taken to set up a system of controls, however, managers will find that others in the firm can keep records and prepare reports. Their own time on a continuing basis will be kept to a minimum, while at the same time they will be able to evaluate their own performance and that of their people and organization.

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Structure of CPA Firms—Time for a Change?

John W. Bickle

Traditional management theory dictates that management cannot modify the work situation, so the people who work must be modified. In other words, people must be made to fit into the work situation as it exists.

How does this conclusion relate to public accounting? Traditional practice dictates that billing and collecting is a partner's or manager's job. Why? Is it because a senior is not capable of preparing a bill? Is it because a senior doesn't know how many hours the job took or cannot be taught how to explain the fee to the client? Of course not, it is none of these. It is simply a traditional management approach.

Here is another example. Traditional practice dictates that only seniors and above are allowed to participate in any planning conferences with clients. Why? Is it because semi-seniors and staff accountants do not have anything to contribute? Of course not, particularly if they worked on the job the year before. Instead, it is a traditional management approach.

Finally, traditional practice dictates that staff should not be allowed to participate in selecting the types of clients they will have. Why? Is it because they want to spend their careers working on public utility or oil and gas audits? Of course not—it is just tradition. After all, it is management that decides who works on which clients, regardless of the desires of the staff.

The key point is this—management has tried to mold people to fit the work situation. Instead of trying to determine what people can do and fitting the jobs to their abilities, they have been *forced* to fit the jobs. Why? Because it is easier to coerce or persuade a person to do a job than it is to redesign the job to allow him to utilize his full abilities and enjoy his work.

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Growing Gap Between Partners and Staff

Unfortunately, traditional management approaches are not the only problem. A number of recent research studies indicate there is a growing gap between the values and ideals held by partners and those held by younger staff members. These studies indicate that partners are becoming more firm-oriented than staff and that staff are becoming more profession-oriented than partners. This, by itself, is not significant. However, as the studies have been extended over a period of five years, it is significant to note that the gap is increasing.

These recent studies, as well as those which preceded them, seem to indicate that life at the top of an organization is going to continue to be more complicated. The time when the boss/subordinate relationship was a simple straightforward affair, when lines of authority were direct and channels of communication were simple, is past.

These studies also reinforce the changes that have long been anticipated—vast changes in education, living standards, and technology. If there had been true observation, however, there would have been no need to tell management about this growing gap. It would have been recognized that younger staff had to change their values. They are only reacting to their own environment—an environment that tells them to become independent, to seek higher ideals, and to do their own thing.

What Can We Do About This?

Most members of the public accounting profession are familiar with the "buzz" words and catch phrases: e.g., motivation—hygiene theory, theory x and y; 9-9, 9-1, 5-5, 1-9, and 1-1, etc. However, many have ignored these findings as not being applicable to accountants' unique professional organizations. But they are not only applicable, they are critical to the continued growth of the profession.

Because they are critical, they must be studied and applied to the profession. For example—

- Management must begin by redesigning the work it asks people to do. This will require that it build back the wholeness in the job. It will require that people be allowed as much decision-making control as is possible in their jobs. It will require that the job be designed in such a way that the individual doing the work gets frequent, direct feedback on his performance. This is the definition of an "enriched" job. Only in this way can employees be provided with interesting and fulfilling work, thus utilizing the greatest amount of their talent in order to achieve a cost-effective operation.
- If their jobs are enriched, they must be able to participate in setting their own performance standards. People who control their own

work are usually highly motivated. They also become more independent and are likely to vary the procedures and methods of doing things more than they have in the past.

- More information must be shared with younger staff. Why shouldn't they know what to expect? What's wrong with letting them decide how much information they need to do their jobs?
- A minimum of external control must be imposed, and people must be expected to exercise self-control. This means operations must be decentralized, authority and responsibility shared, and decision-making power moved down in the organization. They must also be expected to set their own goals and objectives and to participate in setting firm goals and objectives.
- It must be understood that management approaches are not always black or white. Instead, management must be able to adapt its approach to fit reality. It must become a personnel problem solver.

A Few Final Thoughts

Many people are overwhelmed by the problems involved in organizational change. They have lived with the old structure and attitudes and have become accustomed to them. Perhaps they have struggled and survived the system and are afraid to try to change it. Perhaps good advice is *not to do it all at once.* Instead, a firm should take it one step at a time. A large firm should try to get one of its offices to apply these concepts. It is not necessary to change everything in every office at the same time. Small changes should be made and the results should be closely watched.

It would be a good practice to hold a critique of every engagement worked on after it is completed. Everyone who worked on the job should get together and discuss what happened. The kinds of suggestions for changes in work techniques and reallocation of time that arise out of these critiques can be amazing. When people become accustomed to participating in such an activity, they will level with each other in regard to problems on the job.

People should be trained as decision-makers. Most large firms have developed excellent technical training seminars but have done a very poor job in developing behaviorally oriented training programs. Imaginative training approaches must be developed: role playing, case problems, and simulations that explore specific problems in the behavioral area. It may be necessary to employ the use of existing seminars or qualified experts to develop such programs. Everyone in a firm, including partners, needs this kind of training.

Internal policies regarding pay, promotions, and the like should be examined. They need to be discussed with both staff and partners to see if they are adequate to meet everyone's needs. All partners should be convinced that staff attitudes are changing; they should recognize that today's younger staff has a greater interest in doing their own thing. All internal policies need to recognize and reflect this change.

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Round Table Discussions

Anthony T. Krzystofik

In recent years there has been greater concern by accountants in the management of their practices. The increasing cost of professional staff, support services, office space, and equipment has created an interest in reviewing present practices of providing professional services to clients. Accountants have seen the need for closer analysis of revenues, expenses, and operating methods not only for a better evaluation of past performance and present position but for improved future planning as well.

The Institute has recognized this need for improved operating procedures through the publication of the *Management of an Accounting Practice Handbook.* On the state level, a number of studies of accounting practices have been conducted in recent years. Both of these efforts have done much to generate interest in operating practices as well as provide a basis of communication between practitioners. Recently, however, interest is being shown by practitioners in developing programs on a local and regional basis to assist each other in the improvement of their accounting practices.

Round Table Session

In Massachusetts, practitioners have conducted round table discussion sessions on a regional basis for a number of years. The objective of the round table program is to get practitioners from the same area and firm size together to discuss mutual problems in operating an accounting practice. The sessions are sponsored by the Western Massachusetts Area Committee of the state society as part of its annual program calendar.

The sessions generally attract approximately 20 to 25 local practitioners, with the attendance depending on the subject topic.

The format of the two-hour round table session is as follows:

1. One member of the group presents a short summary of the subject based on research of AICPA publications and published materials, and personal experience.
2. A second member follows with a presentation of actual cases or illustrations from personal experience or practice on the subject to be discussed.
3. The remainder of the session is reserved for a discussion and analysis by the group of the cases and possible solutions for improving specific operation situations.

One main topic is generally selected for discussion and, if possible, a practitioner with a unique management or operating technique is asked to make the presentation on actual cases. In effect, the round table is a "show and tell" session with practitioners from the area reporting on how they are handling specific practice management problems. The topics may vary anywhere from a basic office administration problem to such complex subjects as avoidance of professional liability suits. In the past, sessions also have been held on methods of time reporting, office procedures, solving collection problems, establishing a budget or forecast, the effective use of data processing and copy machines, etc.

One of the more popular round table sessions has been devoted to the problem of setting fees for professional accounting engagements. This subject has been discussed a number of times in the past and was repeated again this year with special emphasis given to the effect of the current economy on fees.

The cases used in the round table on fees require the members of the group to determine fees for several different types of professional accounting engagements. A questionnaire is then administered to the group to determine what the billings would be in each case. A summary is prepared of the suggested billings of the group for analysis and discussion. Because data has been carried over from prior periods, detail and trend analyses are available for evaluating the suggested billings and determining how they correlate to the changing economic conditions over the related periods of time. A recent round table session attempted specifically to determine if current fee setting practices of firms in the regional area were responding to the inflating economic conditions. Also of concern was the problem of fee collection and how practitioners in the area were responding to AICPA and SEC statements questioning the independence of accountants when clients had material billings which were past due.

Approximately 25 practitioners representing 20 firms participated in the discussion. Two in the group represented national firms with the remainder small- or medium-sized local practitioners. I handled the fees session and the compilation of the summary of the suggested fees. This was done to ensure anonymity of the responses and, hopefully, to encourage franker participation. An educator also was selected as moderator of the fees round table to ensure "independence" of a noncompetitor.

While statistics on fees are published annually either in journals or as independent studies, this local fees round table continues to be popular. These discussions and statistics, since they reflect local conditions, are more significant to the practitioner than national or statewide statistics. The value of the fee statistics is that they represent information from similar practitioners in similar economic and geographic areas.

Summary and Conclusion

The round table discussion session can be an important step in the improvement of the management of accounting practices. The idea of having practitioners meet and discuss mutual problems in light of local conditions is one that should be encouraged by other regional groups. In fact, the Massachusetts program could be a model for other regional groups to follow. Much can be learned by members attending national and statewide meetings of practitioners, but much more immediate benefit may be received from local discussion of current practice management problems. Furthermore, the round table format provides an opportunity for better communication and local practitioner cooperation. As an example, at one of the sessions on personnel and staff development, the problem of the increasing cost of professional development programs was of special concern to small practitioners in the area. In an effort to provide professional development programs for staff and still control costs, several of the firms cooperated on a joint program whereby Institute and society programs were presented by a member of one of the firms in one of the member offices at a mutually convenient time. This cooperative effort ensured that the staff would not only receive professional development training but also would obtain it at a reduced cost to each of the participating firms.

The round table session not only promoted closer cooperation among practitioners in the area but also helped improve the practice of accounting. The original impetus for the round table sessions came from the Management of an Accounting Practice bulletins published by the AICPA several years ago. With the publication of the AICPA three-volume *Management of an Accounting Practice Handbook,* it would appear that round table discussions may be the appropriate format for other local practitioner groups to meet and discuss the suggestions for improving the management of accounting practices.

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Fees

Luke Ware

Professional Fee Goals and Our Objective

The fees charged by a CPA firm must be sufficient to—

- Compensate both the experienced professional and the new graduate entering the profession at fair levels in relation to others of similar qualification.
- Attract capable recruits, in competition with others.
- Provide benefits comparable to those offered by business in the community.
- Cover the ordinary and necessary costs of running a business including a comfortable office, an adequate library, and continuing professional training and development of all staff members.
- Earn a reasonable return on investment.
- Provide an opportunity for business profits for superior professional services, for meeting exceptional demands of unusual engagements, and for professional responsibilities or risks assumed.

Our objective is to earn fees sufficient to meet the goals outlined above by charging clients fair value for services rendered. We cannot charge more than we believe the value of our services to be; why then should we charge less than that value?

Our Fee Policy

It is our policy to submit billings to clients promptly upon completion of each engagement but only after careful consideration of the value of the work performed. In determining the amount to be billed, consideration will be given to both (1) objective elements—time and expense, and (2) subjective elements—technical capability involved, difficulties or complexities of the job, urgency, responsibility assumed, and value to the client in terms of results achieved.

The suggested billing will then be evaluated in relation to prior billing, fees prevalent in the city, and the client's ability to pay. As a general guide, routine services (ADP, payroll taxes, financial statements, and tax returns with no involved problems) will tend to be billed more on a quantitative basis, whereas services requiring greater professional skills and/or involving complex problems will tend to be billed more on a qualitative basis.

Invoices are due when submitted; frequently, standard monthly or quarterly retainers are being paid, for which credit will be applied. If the invoice amount is greater than in the past or greater than anticipated, it will be delivered in person and explained. In some cases the explanation should be submitted in letter form in addition to personal delivery and discussion.

Certain aspects of fee charges and our policies are discussed in more depth in the following sections of this policy statement:

1. Billing arrangements, estimates, and rates.
2. Factors in setting fees.
3. Invoicing (and statements).

Despite our efforts to state our policies, we cannot anticipate all possible situations. Therefore, there will be occasions when these policies do not fit; such occasions will have to be recognized and considered on their own merits. Likewise, there will be situations in which we might not be paid at all, let alone be paid for the real value of the service. In those situations, we should attempt to reduce the scope of our work; arrange for more client assistance; or even withdraw from the engagement. However, we must always fulfill our responsibility and commitment with professional performance; we cannot sacrifice quality, or create potential liability, for the sake of avoiding collection losses.

Billing Arrangements, Estimates, and Rates

Fees for professional services of good quality are never low; but they can be economical in relation to value received. No product or service can endure, except briefly, if it is consistently sold below cost.

Because of the real difficulty in estimating fees, we often fail to discuss fees with the client at the outset of our engagements. The consequences of such reluctance are problems that arise when bills are submitted. This experience emphasizes the need to discuss fees at the outset of any engagement, and especially a new one. A prospective client certainly has this question in mind, so we should bring it up even if he does not. If we can estimate the cost, we should do so and inform him of the approximate range; but if we can't (as is usual) we should say so. However, we can tell the client what our fee policies are and that our rates have been carefully determined and are competitive—that we will make every effort to do the job promptly, and in as little time as possible—that we do not make work just to run up fees—that we will discuss the fee with him as soon as we can intelligently estimate it—and that we will keep him informed to the best of our ability. Our own confidence in both our professional ability and our fee policies is critical to this process; lack of confidence on our part will certainly make the client apprehensive.

It is our objective to provide our clients with professional services of good quality, but to provide only those services for which the need exists, and only with the knowledge of the client. To do this economically, we must put ourselves in the client's shoes; keep his interest foremost; and keep him informed and involved in the progress of our job. The client must have the opportunity to evaluate the benefits or need for additional services before we expend efforts beyond the scope of our basic job. When we are positive in our recommendations and do an effective job in communicating with the client, our fees will be collected promptly.

Our clientele consists mainly of small businesses, one characteristic of which is a relatively tight cash position. In these cases, it is suggested that a monthly or quarterly (even weekly) retainer fee be established. This is not a fixed fee; it is a payment on account for which full credit will be allowed against the ultimate billing. The client needs us most at the outset of the engagement; so if there is a clear understanding of our fees and retainer payments at the beginning, it is not likely that questions will arise later.

The rates on which our standard billings are based were established to achieve the professional fee goals and our objective, previously discussed. Individual rates are based on realistic evaluation of each person's level of professional skills as related to others of similar skills, and his compensation is determined in relation to such evaluation. A separate factor is used to adjust both compensation and billing rates to reflect the effects of inflation on our economy. The B.L.S. consumer price index is used as a guide in making those adjustments. Individual billing and compensation rates are periodically reviewed and revised with our fee goals in mind; the resulting rates for each person are thus realistic, reasonable and competitive, and reflect his personal professional capabilities in terms of present values.

In the quantitative sense, we attempt to staff each job to produce the lowest quantitative billing to the client; in other words, we attempt to use the proper tools by putting the right men on each job. The next step involves our own proficiency; and this is the professional attitude and capacity that each of us brings to the job; it is our challenge to see to it that the client has full value received in relation to each quantitative hour charged.

We normally discourage discussion of individual billing rates with clients since this is only one of the factors which enters into our billing; however, there are occasions when frank discussion of rates may be appropriate. But the client should be advised of the many subjective factors that also enter into the fee decision.

Factors in Setting Fees

As previously discussed, there are both quantitative and qualitative elements in setting the fee for any professional service. Only the quantitative elements (the objective factors) are susceptible to reliable measurement; the qualitative factors come down to a judgment decision as to what is a reasonable fee.

1. Our records are maintained on the objective basis and thus provide us with the quantitative measures on each engagement, which consist of (a) time at standard billing rates and (b) expenses.

   If we have performed satisfactorily, maintained good communication with the client, and completed the engagement on time and within the hours estimated, we should be able to submit and collect full standard billing for our services. However, when our time is unreasonably high because of our own inefficiency or because we expended time on irrelevant or inconsequential matters, a fee based on our standard time charges might be unfair to the client. We must therefore be satisfied that we have spent time only in the proper areas, and that we have not extended our work in areas which the client might choose to ignore or to accomplish with his own personnel. If we are confident in our own time utilization, we can charge fees at standard rates or greater, if the qualitative elements of our performance justify a greater charge.
2. The qualitative factors involved in setting a fee can be boiled down to "charge what the work is worth." This judgment hinges on many factors, including—
   a. What was the value to the client in terms of results achieved?
   b. What degree of technical know-how or experience was required?
   c. Was our service imaginative and creative?
   d. Did the engagement involve complex procedures?
   e. What difficulties were overcome in completing the job?
   f. What was the urgency factor, or were we able to schedule the job without disrupting other assignments?
   g. What risks or responsibilities do we assume?
   h. What is the client's ability to pay?

i. Was this an old or new client; and will there be future service requirements?
j. What fees would others charge for like services?
k. What is fair for the service involved?

In addition to these, other considerations may apply; but they all lead to the judgment decision of what the work is worth.

3. Despite our policies and the factors involved in setting fees, we and all other CPAs occasionally are faced with situations where discounts are expected or where no billings can be rendered. At present, we follow the policy of discounting fees to nonprofit organizations by 20 percent. Until the groundwork has been completed to change this policy we will have to live with it; however, it is to be disclosed on the face of all invoices. At other times, friends or clients in business distress need services for which it will be difficult for them to pay. But they don't like to be treated as charity cases; don't offend them with gratuitous service; be considerate and lenient, but charge them a minimal professional fee for professional service.

   Any other discounts constitute either inefficiency on our part, or lack of confidence in our service. If it is the latter, the client must also lack confidence in us; so the question then is "are we providing professional level services; or are we using our pencils rather than our heads?"

4. The individual staff member must answer that question for himself; it is his personal obligation to himself, his employment obligation to the firm, and his professional obligation to the client to utilize his training, experience, judgment, and capability to maximize his professional performance in the minimum amount of time. When he does that the client receives full value, he increases his own compensation, and he enhances the firm and the profession.

Invoicing (and Statements)

Although all clients expect to be billed for the services we render, we should never surprise a client by invoicing him when no invoice is expected, or by billing an amount greater than might be expected. It is substantially incumbent on us to pave the way for our billings by keeping key client personnel informed.

The proper time to submit invoices is upon completion of the engagement. We tend to delay billing until the time ledger is processed for the month in which the engagement was concluded. This not only slows down billing and cash flow, but tends to emphasize the quantitative approach to billing but avoid the question of the worth of the service to the client. This can be avoided by estimating the unentered time for the current month, extending it at standard rates, and adding it to the balance shown on the billing memo (as of the close of the previous month).

Billing memos are prepared each month for engagements which have been or soon will be completed. It is our policy that the staff member in charge of the field work first receive billing memos and that he prepare a suggested billing. The billing memos then go to the appropriate supervisor and partner for approval before submission to clients.

It is incumbent on each person in the billing process to assess both his own performance and that of the firm as a whole. He must estimate the value of the service to the client and be prepared to sustain his judgment as to the fee. If he cannot bill the standard time charges, he must account for his time utilization and/or other reasons for discounting the fee.

Billings should be descriptive, and should be carefully worded as to dates or time periods involved. The standard billing descriptions should be supplemented to ensure that the client clearly understands the extent of our work both now and in the future when he may be looking back over our invoices.

If there is a balance due on previous invoices, the balance should be brought forward and totaled with the current invoice, so the client receives an up-to-date statement of the full amount due on his account.

When the invoice is submitted, variations from prior billings or from estimates are to be explained in person. In some cases a written explanation should also be submitted.

Explaining Fees to Clients

Carl S. Chilton, Jr.

The following bulletin was sent to all clients.

The subject of accounting fees is obviously of interest both to us and to our clients. You as a client want to feel you are getting your money's worth for the fee you pay, and we must have fees that are adequate to enable us to give good service. This article, therefore, will endeavor to explain some of the things that enter into the determination of our fees.

The most common method of determining fees for accounting work is based on the time involved. This method has been found to be the fairest for all concerned and is used extensively by most CPAs, including our firm. Other factors can sometimes enter into the picture, however. Some of these are discussed below.

First, with a staff of some 20 people, we have individuals with various levels of training and experience. The billing rates of these individuals vary considerably. We feel that in order to arrive at a fair fee we must assign a person at the right level of experience. We can't expect a client to pay $1 X per hour for a job that should be done for $½ X. This is one reason you frequently find the partners assigning work to others.

Second, when charging by the hour, we have to do an efficient job to justify the charge. If we take 20 hours to do a job that should take 10, we do not feel justified in charging our regular rate. On the other hand, if we are able to perform a valuable service for you in a minimum of time due to prior experience, we may feel justified in charging a higher rate. Superior performance justifies a higher fee; poor performance necessitates a lower fee.

In much of the work we do, we are able to reasonably predict how much time it should take and are willing to make an estimate of the fee in advance. We realize that clients generally want some idea of the cost they will incur. Such estimates cannot be "firm" figures, since we cannot always predict just what we will run into in a job.

The major factor affecting accounting fees today is the cost of getting, training and keeping a good staff. Without a good staff we cannot render service. To get good people we must pay competitive salaries and the current trend in salaries is definitely upward.

Over the years our clients have raised few questions with us about our fees. We hope you have felt that you have been getting your money's worth with us. This discussion should help you gain an understanding of this subject from our standpoint.

Journal of Accountancy, October 1967

How to Increase Fees in Line With Rising Salaries and Wages

Leslie Heath

If you were to pick up a magazine and see that starting salaries for college graduates were 10.9% over the previous year, would you "relate" this information to a need for increasing your fees 27.3%? Usually a rise in starting salaries triggers a rise in all other salaries. The profession appears limited to relating its hourly fees to a "multiplier" or hourly salary cost for purposes of a standard rate. This probably originated from the fact that salary was such a large proportion of total cost. The multiplier usually ranges from 2 to 3 times hourly salary cost, with 2½ times being more frequently encountered. The combination of salary increases and a multiplier produces interesting results. For instance, page 3 of Bulletin no. 1535, issued by the Department of Labor, shows that from 1961 to 1966 wage increases for auditors were up 18.5%. In 1961 the American Institute of CPAs issued Management of an Accounting Practice Bulletin no. 15, "Fee Determination, Costing and Budgeting for Accounting Firms," and on page 17 showed an illustrative average fee rate of $9.72 per hour. The table on page 79 illustrates how fees should change when they are "related" to salaries.

The educational qualifications of those entering the profession have been rising faster than for auditors in general and, therefore, the salary increases in the profession are rising faster than for industry in general. Thus, if increases in starting salaries in public accounting were substituted for auditors in general in the following table the fee increase percentage and rate per hour would likely show a much higher rate per hour in 1967 when compared to 1961.

While the selection of a multiplier may be left to personal choice without any factual support, most firms would feel more comfortable in fee discussions with clients if the fee structure was solidly based on defensible cost projections. Schedule A, pages 80–81, illustrates a sim-

	Salary Increase	*Multiplier*	*Fee Increase*	*Rate Per Hour*
1961				$ 9.72
1961–1962	2.9%	× 2½ =	7.3%	10.43
1962–1963	3.6%	× 2½ =	9.0%	11.37
1963–1964	3.1%	× 2½ =	7.8%	12.26
1964–1965	3.9%	× 2½ =	9.8%	13.46
1965–1966	3.8%	× 2½ =	9.5%	14.74
College Placement Council re Public Accounting				
1966–1967	10.9%	× 2½ =	27.3%	18.76

plified method for reviewing costs and checking on the adequacy of rates. (Figures are only for purposes of illustration.)

In this schedule we will assume annual salaries and hours worked for the senior partner and the junior partner. The salaries for the six remaining classes will be the annual average salaries in private industry in October 1966 Bulletin no. 1535 of the U.S. Department of Labor (page 74). This is a valid assumption, since we would certainly expect that our hypothetical firm would have to pay the staff at least what they could get in private industry. If we then assume that each member of the staff will work 2,080 hours per year, the average hourly cost for each class of staff would appear in Column 3.

To the total salaries we would then add the general expenses, plus a return on invested capital. We have also added an allowance for incentive bonus plus an additional allowance of 15 percent to cover contingencies and to reward the partners for the risks they are taking. This results in a total projected revenue requirement of $132,532.

But we all know that we cannot sell 2,080 hours per year. In Column 4 we will then place, for each member of the staff, the hours which we believe can be charged to clients. If the hourly rate in Column 3 is multiplied by the number of hours in Column 4, we will get the salaries which are allocable to clients, $49,642.

The projected revenue of $132,532 divided by $49,642 will give the multiplier needed. The hourly rate in Column 3 is now multiplied by 2.67, and then rounded off to the nearest dollar. Again we multiply by chargeable hours to be sure we are going to recover the projected fees. On the first test, the rate for Auditor III had been rounded to $11, but this left the proof total short of the projection. By raising the rate to $12 this shortage was eliminated, and also the rate for Auditor III was now in line with the others.

The annual salaries in Column 1 should include overtime compensation, vacation pay, etc.

Ed. Note. *We made this computation for our firm and developed a multiplier of 2.80. We also discovered that our fees for stenographers and typists were too low.*

Schedule A

	1 *Annual Salaries*	2 *Hours Worked*	3 *Rate Per Hr. Col. 1 ÷ Col. 2*	4 *Chargeable Hours*	5 *Col. 4 × Col. 3*
Senior partner	$ 24,000	2,400	$10.00	1,200	$ 12,000
Junior partner	15,000	2,200	6.82	1,400	9,548
Auditor IV	11,196	2,080	5.38	1,600	8,608
Auditor III	8,904	2,080	4.28	1,600	6,848
Auditor II	7,740	2,080	3.72	1,600	5,952
Auditor I	6,408	2,080	3.08	1,600	4,928
Stenographers, general	4,365	2,080	2.10	500	1,050
Typist I	3,678	2,080	1.77	400	708
Totals	$ 81,291				$ 49,642
General expenses	21,135				
Return on invested capital—6% on $60,000	3,600				
Provision for incentive bonuses—5%	6,626				
Return to partners for venture risk and contingencies—15%	19,880				
Projected revenue	$132,532				
Multiplier	$\frac{\$132,532}{\$\ 49,642} = 2.67$				

	Col. 3 Above	*× 2.67*	*Rounded Off*	*Chargeable Hours*	*Proof*
Senior partner	$10.00	$26.70	$27	1,200	$ 32,400
Junior partner	6.82	18.21	18	1,400	25,200
Auditor IV	5.38	14.36	14	1,600	22,400
Auditor III	4.28	11.43	12	1,600	19,200
Auditor II	3.72	9.93	10	1,600	16,000
Auditor I	3.08	8.22	8	1,600	12,800
Stenographers, general	2.10	5.61	6	500	3,000
Typist I	1.77	4.73	5	400	2,000
Proof total					$133,000

Journal of Accountancy, *July 1969*

Useful Reminders About Billing

George E. Greene

Following is a page from our staff manual.

1. Always try to "sell" the fee during the engagement. Prepare the client for the bill.
2. Don't *ever* let a bill come as a shock to the client. To implement this—
   a. Keep client advised as to how much bill is running unless it is in line with previous year.
   b. Advise ahead as to probable cost to extent we can, upon starting engagement.
   c. Except during tax season, when billings are made twice each month, a listing of each client and the accumulated dollars of work-in-process will be prepared. Only those clients showing in excess of $100 and activity during the previous week will appear on the list. The partner in charge should review this list by Tuesday of each week.
3. Before sending out a bill of unusual size, call or write the client to prepare him. The approach is always that of an adviser seeking to do work at the lowest possible fee commensurate with the client's needs—and with ours.
4. When engaged for the first time, we do not normally reduce fees because of the necessary "first-time-through" expense. We don't consider it necessary to bill at reduced rates during first engagements because then, if ever, the client is receptive to higher fees. He has come to us because he needs our services and usually the first engagement results in a great many tangible benefits. The exception to this general rule is the case of a client who is well-established and who has been audited regularly by a reputable CPA firm. Here the "first-time-through" cost is sometimes absorbed because it is not the result of insufficient service having been rendered in the past.
5. A client should receive his bill as soon after the first of the month as possible. This should not be a problem in cases where an engage-

ment is completed during the month or a client payment schedule is based on a fixed monthly payment with year-end adjustments. In other cases, it is only possible by prompt submission of time sheets by the staff and prompt posting of work-in-process records.

6. Determining the bill—hints on preparation—
   a. Do your easy billings first. Then it's easier to deliberate on tough ones.
   b. Never charge more than you would be willing to pay. If in serious doubt, err on the side of reasonableness (Golden Rule).
   c. Never charge more than you can collect. (This implies faulty arrangements with the client or failure to keep him posted. But this has happened once to everyone. When it does—well, reread the rule.)
   d. Except for out-of-pocket expenses, do not use odd figures on invoices. Round them out.
   e. Avoid "lapping." It has a backlash effect and will simultaneously destroy the fee structure and client goodwill. (New partners or supervisors lacking the courage born of experience are likely to be vulnerable on this one.) To be specific, suppose that for a new client you do work prudently worth $165 the 1st month, $110 the 2nd and $100 the 3rd. The thing to do is to bill him just that. If you bill only $125 the 1st month, hoping to make up the $40 later, you are likely to be disappointed and lose out all around, for the client is already conditioned to the wrong yardstick and with brute logic can complain when you bill him the correct $110 the 2nd month.

Management Letter Implementation

H. Robert Nagel

Much continues to be written about developing suggestions for management letters and for the improvement of internal controls. The emphasis is usually placed on formulating ideas, even to the point of developing checklists. However, once an idea has been developed, its presentation and acceptance still remain, and this phase presents its own special problems. Regardless of the inherent merits of a suggestion, unless it's accepted and implemented little benefit is derived by either the client or those making the suggestion. Therefore as CPAs we must sell our ideas and help plan their implementation, if only in general terms.

Following are examples of the multitude of problems or factors which can deter the implementation of changes suggested by management letters:

- In the area of internal controls, the benefits are normally not easily measured, nor the rewards immediately apparent. Although proposed changes are normally presented to individuals cognizant of financial matters and accounting controls, the immediate problems of day-to-day operations can easily overshadow the urgency with which such changes are considered necessary.
- The tendency exists to present in a purely technical manner findings and recommendations which do not deal directly with the immediate problems facing the client. If they do not relate to the client's present objectives and operating methods, acceptance is not likely.
- Recommendations are often presented to individuals who are not well-versed in the areas being discussed. The problems of presentation in such cases become even more complicated and should be recognized and dealt with to the extent possible.
- Although we are dealing with systems, we are also dealing with people. It must be remembered that changes are being suggested to managers who in most instances either set up the present system,

have been operating under it, or have modified the system to their own preferences. Therefore, proposals are often construed as reflecting criticism of their work. Ego can easily dominate all other considerations. There are few situations where changes can be dictated. Where such a situation does exist, it does not necessarily mean that those given the responsibility to implement the suggestions will aggressively make the changes.

It is not uncommon for the correction of a weakness in internal controls to result in the development of another weakness. This usually is due to a poor understanding of the implications of the change. Correcting this new weakness can be difficult because the client may feel that it would never have occurred if he had not listened to the auditor in the first place. Although the auditor may not be at fault, the situation does not help client relations. Such unpleasantness can be avoided by anticipating these problems before implementation.

There are no set rules or procedures that can ensure the acceptance of a proposal. However, here are some factors which can be advantageous in securing the implementation of suggestions.

Involve the Client

Get management, and those employees affected, interested by having them take part in the development of suggestions. Ask the client and his employees if there are any areas where they are having problems. They probably know the problem areas better than anyone else, but may not know the solutions; or they may lack the necessary status or authority to initiate changes. It cannot be emphasized too strongly that this approach does not mean getting involved in office politics. Merely listening to these problems can encourage cooperation.

Emphasize Improvements

Most recommendations tend to be directed at correcting internal control weaknesses. When making recommendations of this nature, emphasize improvements in the efficiency of operations that will result. Such benefits make a more convincing proposal. An example would be the rotation of job assignments to strengthen internal controls while simultaneously limiting the effects on operations of employee turnover, sickness, and vacations. Thought should also be given to proposing implementation of suggestions in the most affirmative manner.

Encourage Compliance

Total compliance or acceptance is not easy to achieve and does not come without approval and understanding of the objectives. The policy of many companies is to write a letter answering the comments made by the auditors. This affords compliance to some degree, but does not ensure that the change will in fact be made. If the individuals given the responsibility to implement the change are not convinced of its merits, the benefits that could be derived may never be realized.

Maintain Good Relations

One of the advantages of making suggestions to management is the maintenance of good client relations. Suggestions can serve as the medium to maintain contact with clients during the year, and not just at audit time. In many engagements the only contact with the client is during the audit. By continuing to take an interest, the auditor can determine whether the suggestions are being implemented, keep in contact with the client, and give assistance when needed.

These considerations are not conclusive. They're only illustrative of the factors which can influence the implementation of changes. Through the development of a total program of discovering, presenting, and implementing suggestions, intended results can often be obtained.

Although direct involvement differs measurably during implementation, the final success of the proposals is dependent on this phase. The auditor must direct himself to the factors listed above and take appropriate action. Ultimately, success will rest on the client's accomplishment, and not merely on the inherent merits of the auditor's suggestions.

Practice Continuation Agreement Checklist

Practice Continuation Committee, Dallas Chapter, Texas Society of CPAs (1968–1970)

More and more sole practitioners are showing an interest in a standby agreement whereby a larger firm agrees to take over the practice in case of disability or death.

Several years ago the Texas Society of CPAs made a study of these agreements and published the following checklist outlining the points that should be covered.

I. Contractual agreement.

II. Terms and conditions for contract to become effective—
  A. Temporary disability (how determined).
  B. Permanent disability (how determined).
  C. Death.

III. Provision for assumption of practice—temporary basis—
  A. Furnishing of employees.
  B. Compensation arrangement with assisting practitioner.
  C. Conclusion arrangement—after temporary disability terminates.

IV. Provision for assumption of practice—permanent disability, death, including—
  A. List of clients—comparative fees for three-year period.
  B. Working papers.
  C. Files.
  D. Books and records, including financial statements and copies of tax returns.
  E. Work in process, accounts receivable, and unbilled work—
    1. Provision for billing and collection.
    2. Provision for service fee, if any.

F. Provision for tangible property, furniture, fixtures, equipment, and supplies.
G. Provision for existing leases.
H. Provision for employees of disabled or deceased practitioner—
    1. Copies of employment contracts.
    2. List of employees, ages, salaries, length of service, fee scales, etc.
I. Provision for existing liabilities—contingent liabilities.
J. List of insurance policies, including accountants liability insurance.
K. Statement of fee structure by major category such as hourly rates, etc.

V. Payment for practice—
  A. Percentage of fees—
    1. Number of years payout—fees billed and collected.
    2. Tax treatment to be considered.

VI. General provisions—
  A. Competition agreement until effective date of this agreement.
  B. Provision for termination of agreement by either party.

Journal of Accountancy, *November 1967*

Continuation of a Practice

William A. Olson

Late in the evening of Sunday, May 23, 1965, a CPA in Boise, Idaho, received a telephone call from a newspaper reporter notifying him that a fellow CPA and his wife, both close friends, had been seriously injured in an automobile accident. He gave the reporter the personal data needed for his story and he also told him that a committee of the Idaho Society of CPAs would supervise the practice until this CPA was able to return to work. The reporter included this statement in his story.

This CPA then notified the officers of the state society, who approved the action taken and immediately called the society's emergency professional assistance committee to active duty.

The injured CPA died the following Thursday evening, but by this time the widow had regained consciousness and had signed a formal request for assistance (Exhibit 1) which was prepared by her attorney. Of obvious importance is the last paragraph releasing the committee from liability.

Next a letter was composed (Exhibit 2) on the deceased CPA's letterhead and was in the mail to every client within 24 hours from the time the request for assistance was authorized.

The committee then called a meeting, notifying all CPAs by telephone in order to eliminate the delays in writing and mailing a notice. CPAs practicing in towns where out-of-town clients were located were also notified. The committee advised all firms to send representatives who were authorized to contract, as this would be the only meeting.

Meanwhile the committee prepared a folder on each client containing the following information:

1. Client name and mail address.
2. Type of business and business form.
3. Calendar or fiscal year.

4. Whether services were rendered at client's office or in the CPA's office.
5. A yearly analysis of time classifications, rates, and annual billings for the past five years, and the type of services rendered.
6. Indication of any nonrepetitive work.
7. Work-in-process, showing time by the classification and type of work. (If the filing deadline was near for any work-in-process, the committee obtained an extension of time from the proper authority.)
8. Amount of any billed and uncollected fees.

Exhibit 1

[*Letterhead*]

[*Date*]

To The Emergency Professional
Assistance Committee of Idaho
State Society of CPAs
Boise, Idaho

Gentlemen:

I accept your offer of assistance in behalf of the estate of John Doe, CPA, deceased, in disposing of decedent's practice.

You are authorized to enter the office of decedent, examine and take over all files, books and records pertaining to his practice and take whatever steps you deem necessary or advisable in the notification or interviewing of clients, all in accordance with sound ethical practices, and the general procedures of your emergency professional assistance plan.

I understand you will compile a history of clients and fees, and that you will arrange, in accordance with the plan mentioned above, to transfer the clients' accounts, with their consent, to interested CPAs to provide the estate of John Doe and me with the maximum economic benefit. In so doing you will use your best judgment as prudent men.

I will appreciate your consulting with me and my attorney, Richard Roe, from time to time, and hereby release you and each member of the committee from any liability of any kind arising from your acting in good faith in this matter. Your interest and efforts are most sincerely appreciated.

Mary Doe

Exhibit 2

[Letterhead]

[Date]

To the Clients of John Doe

Dear Client:

You are undoubtedly aware of the untimely death of John Doe. As one of the clients who made it possible for Mr. Doe to enjoy a fine professional reputation both as a certified public accountant and as an adviser, I feel sure you will be interested in the plans being made for the orderly disposition of Mr. Doe's practice. I also feel you will wish to make arrangements in the near future for the continuation of the type of professional service Mr. Doe has so ably given you. Mrs. Doe has asked the committee on emergency professional assistance of the Idaho Society of CPAs to assist her in effecting an orderly transfer of your work to another certified public accountant of your own choosing.

It is the desire of the committee that this be accomplished without any undue hardship upon you and without any interruption in the type of service Mr. Doe has been performing for you.

The Idaho Society of CPAs has long maintained a committee on emergency professional assistance for the specific purpose of handling situations such as the one with which we are now confronted. The committee is functioning solely for the best interests of the clients of Mr. Doe, and for his estate.

The committee serves all deceased or incapacitated certified public accountants without obligation and without compensation. You, as a valued client of Mr. Doe, are under no obligation or compulsion to accept the program outlined here. Since, however, you were vitally interested in Mr. Doe as your certified public accountant and adviser, we are hopeful that your continued support will be forthcoming. Your doing so will maximize the benefits to Mr. Doe's estate, and we believe it will be of benefit to you also.

Your account is a valuable asset of the estate, and it is contemplated that a certified public accountant that you select will be willing to acquire Mr. Doe's working papers and other data concerning your accounting. There will be no charge to you for this orderly transfer to another certified public accountant. In the meantime, your records and Mr. Doe's working papers and files are remaining completely confidential. They will not, in any manner, be examined or disclosed to any person, until you have made your determination and selection of the certified public accountant who will serve you in the future. Once you have selected the successor CPA, Mr. Doe's working papers, files, and your books of account, including all pertinent data, will be transferred to

Exhibit 2—*Continued*

him. You may then confer with the certified public accountant or, if you so desire, he will contact you.

On behalf of the committee, I will soon give you the names of the CPAs participating in this handling of Mr. Doe's clients. At that time, we will request that you designate the certified public accountant with whom you wish to work, and the immediate transfer of all data concerning your account will be accomplished.

Mr. Doe took great pride in his clients, and it is surely the desire of the committee and Mrs. Doe that the same high plane of service be maintained for you. The program outlined has been used by certified public accountants all over the United States in assisting orderly dispositions of accounting practices under the circumstances caused by Mr. Doe's death. The committee functions solely for this purpose. We most appreciate your cooperation, and if questions arise not covered in this letter, will you be so kind as to contact me, as chairman of the committee on emergency professional assistance for the members of the Idaho Society of CPAs at 302 Lincoln Building. The telephone number is 344-4321.

Very truly yours,

John Smith, Chairman, Committee
on Emergency Assistance,
Idaho Society of CPAs

A coded list of all clients, not disclosing the client's name (Exhibit 3) was prepared for distribution at the meeting.

Each CPA or representative at the meeting was told to review the list and make a separate written offer for each client he would like to

Exhibit 3—Client List of John Doe, CPA

Calendar year unless otherwise indicated
Work performed in CPA's office unless otherwise indicated

	Hours and Rates		
	CPA	*Typist, Bookkeeper*	*Billed*
1. Local Retail Hardware			
Close books; Form 1065; F.Y. 6-30	10 @ $15	6 @ $5	$ 180
2. Local M.D.			
Monthly accounting and 1040	8 @ 20	60 @ 5	460
3. Local Manufacturer			
Audit; Form 1120; F.Y. 9-30	60 @ 20	16 @ 5	1,280
4. Local Retailer			
Form 1120; F.Y. 6-30	4 @ 20	4 @ 5	100

Exhibit 4

The following is a list of CPA firms interested in taking over your account from the estate of John Doe, CPA, in accordance with the enclosed letter (Exhibit 5):

Firm Name ______________	Address ______________
Able & Baker	Main Street, Boise
Knight & Day	Broadway, Nampa

To: The Estate of Mr. John Doe
c/o Mrs. John Doe
801 Smithers Building
Boise, Idaho

The undersigned selects ______________________________, CPA, to continue the professional services formerly rendered by John Doe, CPA, deceased, and authorizes delivery to the CPA named any of our records and workpapers relating to our account in possession of the estate of John Doe, CPA.

____
Name of Client

Date ______________ By ______________________________

serve. The terms were generally 20 percent of the fees to be collected over the next five years, but not in excess of the amount billed as given on Exhibit 3, payment to be made within 30 days after the close of each calendar quarter. Collections by the successor CPA were to be applied first to the decedent's unpaid fees and work-in-process.

Work-in-process was to be completed and the fees divided between the successor and the decedent's estate on the basis of hours invested by each.

After the meeting all written offers were first turned over to the widow for review, and were then sorted in order of clients.

Each client was sent a list of those CPAs who had indicated a desire to serve him (Exhibit 4) with a covering letter (Exhibit 5) on the decedent's letterhead and signed by his widow. The client made his selection at the bottom of this list and returned it to the widow for approval.

The CPA selected was then notified and required to sign a combination contract and receipt for all workpapers and records (Exhibit 6).

Only six clients had not made a final selection by June 14, the last one waiting until October 5.

Exhibit 5

[*Letterhead*]

[*Date*]

Dear Client:

As the legal representative and heir of John Doe, CPA, deceased, I am writing to advise you that the committee on emergency professional assistance of the Idaho Society of CPAs has offered to assist you in making arrangements for the continuation of your former professional service without any undue hardship or interruption to your requirements.

I am enclosing a list of members of the Idaho Society of CPAs who have agreed to continue this service *with your consent.* The certified public accountants on this list are competent and reliable for your type of work. You are not obligated to select any of those listed, but your choice of one of those on the attached list will benefit and facilitate the orderly disposition of the estate, as well as provide continuity of service to you.

Space is provided at the bottom of the list for your use in advising the committee of the certified public accountant you select, and authorizing the estate to turn over to the person or firm named by you any of your records, books and papers, and the working papers belonging to Mr. Doe. You should complete and sign the form and return this authorization.

Mary Doe
c/o 801 Smithers Building
Boise, Idaho

Of course some clients chose to select other CPAs, but the dollar value processed by the committee represented 66 percent of the prior year's gross fees.

A more significant figure could be called "transferable practice," determined by eliminating nonrecurring engagements. The committee handled 80 percent of these transferable fees and 71 percent of the transferable clients.

On July 30, 1965, the committee was notified of the death of another CPA and once again the committee went into immediate action. This time it was able to transfer 66 percent of the prior year's gross fees, 88 percent of transferable fees, and 82 percent of the transferable clients. The work was substantially completed by September 2.

As a result of these experiences, the Idaho committee has some comments which should be of interest to other committees, as well as to small practitioners and small firms everywhere.

First and most important: Time is of the essence. Do *not* wait until after the funeral; act immediately.

The committee *cannot overemphasize the importance of good working papers.* The realization for these two estates was higher than might be expected in most cases because the working papers of both CPAs were in superior condition. The fact that these two men had been planning to merge with others may account for this.

Some negative reaction from the clients had been expected; however, most of them appreciated the assistance offered their former CPA and also the protection which the program afforded them.

Certainly every practitioner has some clients who are underbilled. There were some in each case. Realizing that there might be less interest in these low-fee clients, the committee suggested at the meeting of the participating CPAs that this should not deter them from making an offer. Those who did make an offer were surprised to discover that most of those clients were aware that they had been undercharged and agreed to accept future billings at a more realistic rate.

Exhibit 6—Receipt From Successor CPA for Records

Received from the representative of the estate of John Doe (deceased), 801 Smithers Building, Boise, Idaho, the following working papers and other documents for the purpose of rendering professional services to____________

____.

(Name and address of client)

I hereby agree to pay 20 percent of the fees billed over the next five years but not in excess of $__________.

Payment is to be made within thirty days after the end of each calendar quarter for fees collected during the quarter.

I will complete any unfinished work and prorate the fee on the basis of decedent's hours and my hours.

All collections from this client will be first applied to fees billed but unpaid at date of death, and to work-in-progress, until paid in full.

________________________________, CPA

____

(Address)

Date____________________

The committee believes that a bulk transfer of these two practices would not have produced as large a realization—many clients had definite ideas about whom they would select to serve them since the decedent no longer could.

While the program was developing, many participating CPAs were approached by nervous clients. All were advised to be patient and to make their selections from the list which they would soon receive; most of them did wait.

The first case took a total of about 180 to 200 hours, the second one approximately 96 hours, since the work of setting up the procedures and designing forms and letters did not have to be repeated.

Two members of the committee will continue to keep records for the widows, all necessary information being reported to them by the participating CPAs. Of course, it will be several more years before the final dollar realization will be known.

While there was no publicity other than the newspaper story mentioned, the program and its success received very favorable comment by word of mouth throughout the community.

There were special situations that did arise as one would expect in such complex negotiations with so many different personalities; however, these situations posed no insurmountable problems as the committee found that they were dealing with gentlemen.

The Transfer of an Accounting Practice

Paul D. Torres

As part of a doctoral dissertation dealing with the problem of establishing the value of an accounting practice, I interviewed 24 certified public accountants who had acquired 27 accounting practices. As a windfall I received 17 actual transfer agreements.

Although the circumstances of each case are different and each of the contracts is unique, certain basic considerations are found in most of the agreements. The purpose of this article is to present the characteristics which should be considered basic to an agreement to transfer an accounting practice.

Significant Dates

Two dates are necessary: the date of the agreement and the effective or closing date for the transfer.

Identification of Parties

The name, location, and profession of both parties to the agreement are presented in the contract.

Intention of Parties

The agreement includes a statement that the seller desires to transfer all or part of his practice to the purchaser, and that the purchaser desires to acquire all or part of the seller's practice.

Identification of the Assets to Be Transferred

A list of the clients to be transferred to the buyer is a part of the agreement. Other assets to be sold, such as furniture and office equipment, are also identified. If accounts receivable are to be sold, this is stated in the contract. In any event, a specific cut-off date should be stated, after which billings belong to the buyer.

If the price is contingent upon future fees, agreement is necessary as to what is included in "fees." For example, the agreement might include as fees compensation for services rendered to any new or extended operations of clients covered by the agreement in which ownership of the client or clients amounts to 50 percent or more of the new enterprise. Additionally, fees might include the proportionate part of the fees arising from a merger of clients acquired in the transfer with other clients of the buyer in the ratio of their respective ownership interest in such enterprise.

Purchase Price

Whether the price to be paid for clients is a definite amount or is contingent on future fees, the contract should clearly indicate the amount or formula agreed upon. If assets other than clients are to be sold, and their sale is part of the agreement, the consideration to be paid for these assets should be stated.

Method of Payment

The agreement contains the amount and date of each payment, the time period in which the payments are to be made, and the interest charged, if any.

Seller's Warranties

The agreement includes the warranties or guarantees of the seller. Common examples of such warranties follow: (1) the clients listed are bona fide and the amounts given as previous billings are correct; (2) there will be no outstanding liabilities against the practice at the closing date, or should some occur, the seller will take responsibility for any such claims which might exist; (3) the seller holds clear title to all assets (other than clients) to be transferred; (4) the seller will assist in the transfer of clients to the buyer in the mutually agreed manner; (5) there will be no prepaid services existing on the closing date, or if these prepayments are expected, an agreement by the parties as to their settlement will be made; and (6) the seller guarantees that he will continue to operate the practice in a professional manner until the closing date for the transfer.

Buyer's Warranties

Common guarantees of the buyer include the following: (1) he will not incur any obligations in the name of the seller; (2) he will operate the purchased practice in a professional manner; (3) if the purchase price is contingent on future service to the acquired clients, he will not raise fees to the acquired clients for an agreed upon time period after purchase; and (4) he will keep accurate records and will allow the seller to audit the records on the purchased clients. When the buyer assumes the seller's lease, he also warrants that he will make the rental payments.

Noncompetition Clause

The majority of transfer agreements include a clause restricting the competition of the seller. The features of each clause are, of course, different. Not all are as explicit as they should be, but there are certain points which should be part of any noncompetition clause: (1) the date the restriction begins and the total time it is to be in effect; (2) the nature of the restriction and the type of employment or professional activities prohibited by the agreement; (3) the geographical limits of the restriction; (4) events which will terminate the restriction; (5) action to be taken in case of a breach of the agreement; and (6) the consideration paid or allocated to the covenant not to compete.

Transfer of Clients

Agreements should contain the method by which the seller agrees to aid the buyer in securing the transferred clients. In some cases, this amounts to a short-term employment contract where the seller might agree to four months' employment at a stipulated monthly salary, with the stated purpose of the employment to assist the purchaser in securing and retaining clients. In any event, the seller should be available for consultation in regard to matters which arise after the transfer, but which are attributable to events which occurred before the transfer.

Intent of the Parties Regarding the Income Tax Treatment of the Price Paid for Clientele

The tax intent should be clearly stated. There are three possible tax treatments accorded the seller and the buyer upon the transfer of a professional's clients. The transaction might not be called a sale, but the receipt of and the payment for services still rendered. The seller realizes ordinary income and the buyer claims a deduction as an "ordinary and necessary" expense under the Internal Revenue Code, Section 162.

A second approach is to treat all or part of the price as consideration for a noncompetition covenant. Here, the amount received by the seller is ordinary income. The purchaser has a deduction, provided he can prove the expenditure to be "ordinary and necessary" within the meaning of IRC Section 162. The deduction is realized over the life of the agreement.

A third treatment of the payment for clients is that of goodwill, a capital asset. The seller recognizes capital gain measured by the difference between the amount of the consideration received and his basis in the asset—generally zero, unless it had been previously purchased. The buyer has purchased what is generally considered to be a nonamortizable capital asset. Goodwill is rarely present in the transfer of a practice. Of course, whether it is or is not depends upon the facts of the particular case. Goodwill would be evidenced, for example, if the new owner wished to use the former practitioner's name.

Also, the basis for the tax treatment should be established as firmly as possible. For example, a separate contact for professional services or for a covenant not to compete would ordinarily be desirable.

Cut-off Agreement on the Professional Services to Be Performed by the Seller

Dates should be determined as to when the buyer shall begin performing each type of service for the clients. For example, the parties agree that the seller will prepare all tax returns where the clients' fiscal years end prior to the effective date of the contract, and that the buyer will be responsible for all audits which are not completed by the effective date.

Miscellaneous Provisions

Miscellaneous matters include the use of the seller's name, the buyer's disposition of mail addressed to the seller, and the use of the seller's telephone number.

Parties Bound by the Contract

The parties bound by the contract should be identified. A common statement is that the agreement shall bind and inure to the benefit of the buyer and seller, their successors, heirs, and assigns.

Signature of Parties

The contract is signed by both the buyer and the seller. It is desirable to have the signatures witnessed.

Journal of Accountancy, *August 1971*

A Step Toward Professional Unity

George E. Greene

The following letter was sent to all local CPAs when I opened a new office in the community.

It occurs to us that your firm as well as the other firms in town will get feedback on the opening of our new office which could develop strained relations.

We've always tried to maintain a highly ethical and top-level professional firm. We also believe it particularly desirable to maintain friendly and cooperative relationships with our fellow professionals. Along this line let us state the policy we have found to be the best in the long run in several areas of interest to you:

1. We all have clients who for one reason or another may welcome the opportunity to contact a new CPA.
2. If we are contacted by a prospective client, our procedure is somewhat as follows:
   a. Determine if it is now represented by a CPA or PA.
   b. If it is so represented, ask if that accountant knows it is planning to leave.
   c. If it is represented by another accountant, we will ask why it wants to change and advise that it is our custom to discuss the account with the present accountant.
   d. If the discussions in *c* still leave the prospective client dissatisfied with the present accountant and it develops that we can accept the engagement, we will insist that the accountant is paid before we are.
3. In line with the above, we rarely consider complaints on fees as a proper basis for changing accountants. Moreover, we will not assure a prospective client that we can do a job for less. We consider that your personnel are competent and that our rates for the same level of personnel are in line with yours.
4. If we do succeed another accountant, we try to obtain permission to review the accountant's files and obtain copies of pertinent data. In

such instances we expect the accountant to bill us for any time spent by him or his personnel and for any copies involved. This policy should reduce possible embarrassment between the accountant and former client as well as assuring the previous accountant of payment for the added services involved.

The above might be interpreted to mean that we may not be interested in building our practice. On the contrary, we set up this office because we have had several sizable accounts in the area for years. We will try to build a CPA practice here that will eventually be looked upon as a factor to be considered when a new business is looking for a CPA. In our experience, very few accounts actually change hands in a situation of this type. (Most that do are viewed with as much relief as sorrow by the previous CPA.)

If you consider that we have not followed the policy outlined above or in any other way acted in an unprofessional manner, we hope you will call us to discuss it. Third-hand information has a way of becoming distorted and full of half-truths. Moreover, some of our personnel could overstep without our authority or knowledge and we can do something about it only if we know of it.

Journal of Accountancy, *January 1970*

Applications of Management Theory to the Small CPA Firm

John M. Mann

There has been an increasing growth of small accounting firms in recent years, but unfortunately there has been a high mortality rate as well. Much too often, an accounting firm will begin practice and continue to function without any considerations of management theory. Practitioners in these smaller firms argue that they possess neither the time nor the resources for any applications of management theory. They regard it as applicable only to larger firms which have committees and office managers for adequate utilization.

Contrary to these beliefs, the need for management theory is greater than ever before. The small firm is growing more and more complex; efficient operation and possibly even the survival of the firm will be the principal rewards of devoting more time to administrative functions.

Planning

Much too often, no formal planning procedures will be instituted in the small firm. Instead, the practitioner will rely upon intuition and experience in meeting new organizational problems which arise. This management function should be the first to be realized, because it is the cornerstone of management theory.

The planning process is directed at achieving either short-, intermediate-, or long-range goals through coordinated actions. An important aspect of this process is to plan realistically. Furthermore, plans should be flexible and aimed toward the integration of the short-, intermediate-, and long-range objectives of the organization.

Short-range planning should involve no more than a 30-day period and include such areas as budgeting and work assignments. Intermediate planning should involve at least a year and enable the accountant to plan for the efficient operation of the organization during the next year. Intermediate planning might best be accomplished during the summer months, when there is sufficient time to analyze the stresses of both year-end audits and the tax season. Short-range and intermediate planning should encompass all aspects of the firm. Here are examples of a few general areas:

1. Budgeting for the firm.
2. Planning for the development of new clientele.
3. Planning for seasonal staffing needs.
4. Planning for auditing and other engagements with clientele.

Long-range planning should involve from one to five years and should be carefully integrated with short-range and intermediate goals. Three of the general areas to be considered are—

1. Growth of the firm.
2. Economic changes.
3. Technology.

Growth of the firm would include such factors as planning for new clientele and future staff requirements of the organization. This is an important factor to consider when one realizes the average growth rate of the successful small firm is from 20 to 40 percent a year. Economic changes are not always predictable and make the future dependent on decisions of today. Also, with the increased use of the computer, the accountant must plan for future changes in technology. The increasing use of EDP systems by both the clientele and the accounting profession should lead to an emphasis of planning to learn the general concepts and applications of computer technology.

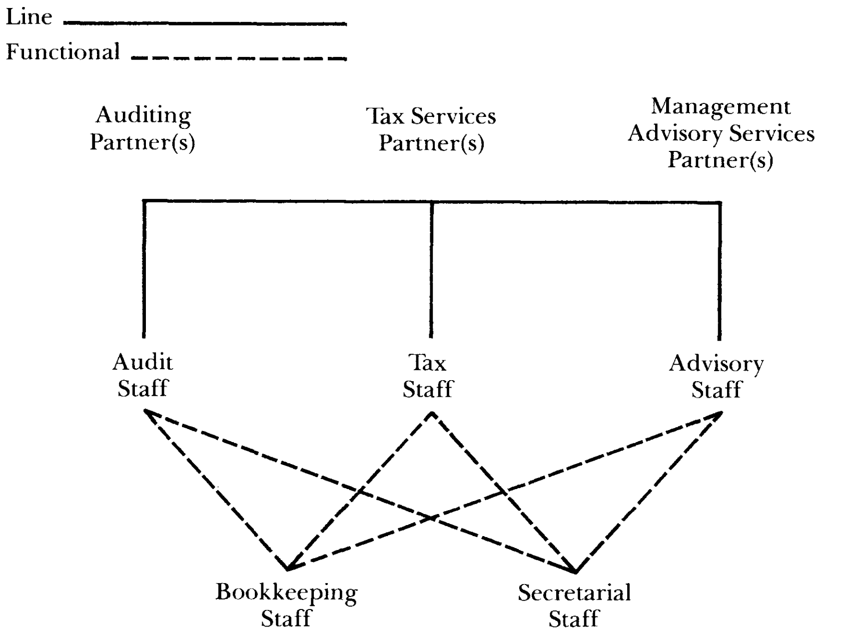
Organization

The first step in the organization of the firm should be the organizational chart, establishing the number of levels and grouping the work functions in a manner which clearly implements the objectives. By establishing an organizational chart, previously unforeseen functions will be exposed and clear lines of authority will be properly delineated.

The second important element of organization is leadership of the firm. In the case of individual ownership, the identity of the legitimate leader is easily seen, but who is the leader in a partnership? In this case, a team approach would offer the best solution. The partners should pool their knowledge and perform duties in the areas in which they have particular strength. An example of this team approach would be as shown in Exhibit A.

If this is impractical because of the firm's clientele, an assignment of certain clients to each partner might provide the solution. Under this

Exhibit A



approach, the partners would act as a committee in dealing with administrative processes of the firm.

Regardless of whether a team approach or committee plan is implemented, the common pitfall of failure to select a managing partner must be avoided. He should be responsible for all minor management decisions and devote time to the management processes as the size of the firm necessitates. Furthermore, his most important role should be to coordinate the management functions and act as a chairman of the management team when the partners meet periodically to discuss management problems.

After leadership has been established in the firm, the staffing of subordinates should be considered as another important element of organization. The types of personnel selected should fit the character of the firm. If the firm is highly involved in auditing, a person should be willing to travel and constantly work out of the office. Time and time again, the small firm will lose its personnel after one or two years because of improper selection.

Seasonal staffing is also a problem that plagues the smaller organization because of its heavy load. Good management techniques would involve a slight overstaffing of the firm and the training of bookkeeping personnel to handle simple tax returns.

The last and probably one of the most important management functions is staff training. By this is meant the guiding of development and the setting of standards for progress measurement. The partners must spend the time and money to adequately train the staff to perform their job assignments. The individual practitioner or partner may immediately pose the problem of the cost and time factor of training sessions. The best procedure in this case is on-the-job training by either one of the partners or the one-man owner. Many clients are lost every year because of staff who do not possess the knowledge required to complete audits or other client engagements.

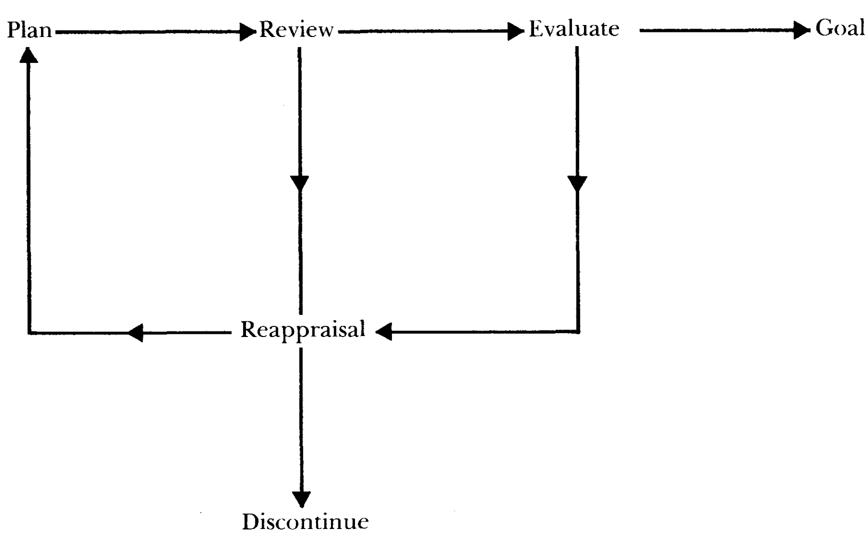
Direction

Another important function for the practitioner is the guidance of the whole administrative process. Not only must one motivate his staff toward the firm's objectives, but he must maintain guidance of actions toward the planned goals throughout the entire structure of the organization. Some effective devices for achieving direction in the firm may be budgets, policies, procedures, and schedules.

Control

In exercising the function of control, the practitioner must clearly have established the planning process. He should periodically review each plan to see if it is achieving the desired results. If the plan deviates from

Exhibit B



accomplishing the firm's objectives, the plan should be revised to correct the performance. If a revision procedure is insufficient, the plan should be reappraised and either be discontinued or redeveloped. Exhibit B demonstrates this system which is actually one of many types of feedback processes that will prevent operating procedures from getting out of control.

Conclusions

This article is offered to stress the importance of management theory in the accounting profession and to propose a framework for solution of the growing and unrecognized managerial problems in the small accounting firms of today. Applications of this theory will not solve every problem, but a proper implementation and integration of the managerial functions will certainly aid in solution of the high mortality rate of smaller firms.

It cannot be overemphasized that the application of management theory and techniques in small firms may be the key to their success, and possibly their survival.

On Being Small

Betty T. McGill

Not long ago I had the pleasure of conversing with a family physician, the "sole practitioner" of the medical profession. His philosophy of practice was captivating.

He is a medical perfectionist who tries to know each patient and his family well—what their interests are—what makes them tick; he encourages patients to call any time they have a problem; he purposely keeps his practice small so that he can provide quality personal service to his patients; and he consults with specialists if necessary. He explained that he manages and controls his practice rather than the other way around. This man is a relaxed, well-informed, intelligent human being who knows what he's about and where he's going.

Family physicians, you may recall, rejected pressures on them to specialize or practice group medicine. Sole practitioners of the accounting profession, although not organized, are much like family physicians. They function alone, as generalists, because they choose to do so, and many have no present intention of changing their mode of operation.

Our nation's strength has depended on and been built by individualists. Yet today we see bigness in the professions, government, and business bent on destroying this basic national character which made our country great. We are allowing ourselves to become robots. No longer do we approach a problem with a pinch of imagination, a sprinkle of enthusiasm, and mix with creative thinking. No, we pull out a "cookbook" and follow the route someone else has determined for us.

Sole practitioners in trying to defend their resistance to this trend are often prodded to justify their convictions; yet, they, in turn, don't feel compelled to castigate the "bigness is best" orthodoxy. Instead, the persuasion is, I'm OK, you're OK.

As well as offering custom service to clients, the sole practitioner can tailor his practice to suit his way of life, health, family responsibility, and personality. Like the family physician, he is involved in the higher significance of *being* as opposed to *acquiring*.

Accountants with a *being*, as opposed to an *acquiring,* standard might interview a potential client, sense that he doesn't conform to an unhurried life style and accordingly refer him to someone else. Structuring a practice after this fashion enables one to reap the benefits of a gratifying day. One finds time to read, exercise, follow current events, make new friends, and enjoy the good things of life. Another plus is that a practice load can be quantified to fit health limitations. In so doing, no one else is inconvenienced as would be the case in a partnership.

If the practitioner and his clients appreciate friendly people, trees, flowers, and birds, he is in a position to select an environment away from freeways, tall buildings, crowded elevators, and other common city annoyances. He is able to locate his office in an atmosphere compatible with his own personality.

"But," you might ask, "what about income?" The income level is determined by the CPA himself. The *being* sole practitioner, as opposed to the *acquiring* practitioner, by spending less time at his office, chooses for himself a lower plateau of earnings than would be the case if he worked seven days and seven nights per week. He is careful, however, not to sacrifice quality of practice. This premeditated economic choice often means accepting simpler pleasures, owning smaller cars, living in less pretentious homes, going on non-European vacations, etc. In essence, one becomes a rat race drop-out—not a bad life at all.

An impossible dream? No. Propaganda? Yes, and if it intrigues you, try it, you might like it.

2

Relations With Clients

Journal of Accountancy, *October 1967*

Why Do Clients Recommend You?

Richard C. Rea

Whenever we have completed an engagement which leaves our client highly pleased, we hope that he will recommend us to others, and in that way we will acquire a reputation which will bring new clients to us.

But why does a client recommend us? Just because he is pleased with our services? "Not necessarily so," says Ernest Dichter, president of the Institute for Motivational Research, Inc. In the November–December 1966 issue of the *Harvard Business Review* he analyzed how word-of-mouth advertising works. His company's research disclosed that it has accounted for as much as 80 percent of the sales of a product.

Since word-of-mouth advertising can be so effective, why not study his principles? If we know what motivates our satisfied client to recommend us, perhaps we could determine how this practice might be encouraged.

Let us imagine then that you have a satisfied client who is in a conversation with other businessmen. Dr. Dichter says nobody does something for nothing. *Not even your satisfied client!* If he recommends you he expects to get something for it—a personal sense of satisfaction or an emotional kick.

There are eight situations in which he might recommend you.

Gaining Attention

He has been sitting quietly for half an hour listening to the others talk and now he wants to say something to attract attention. Pleased with his recent experience with you he decides to tell the others. He breaks into the conversation with the comment, "Let me tell you what my CPA did for me. . . ."

Showing Connoisseurship

Let us suppose that several of those engaged in this conversation have made statements with an air of superior judgment in financial matters. Some quoted their CPAs to support their opinions. Wishing to demonstrate that he, too, is a judge in financial matters, your client quotes you.

Feeling Like a Pioneer

Let us now assume that your client has had no prior experience with a CPA and neither have several of the other men in his group. He is pleased with your services and feels sorry for those businessmen who have not discovered what a CPA can do for them. With the zeal of one who has made a great discovery and now wants to tell others, he breaks into the conversation: "Let me tell you what my CPA did for me. . . ."

Having Inside Information

Your client is in a group of people who are exchanging confidences, tips, and leads—information which is possessed only by those who are "in the know." Your client hopes to attract favorable attention to himself by imparting information which he is sure the others will not know. Again he might start out, "My CPA told me today confidentially. . . ."

Suggesting Status

We have watched with great interest the acceptance of the audit as a status symbol in our community. Some of these audits, we are convinced, were requested because other businessmen in the community, who have achieved status, were having audits. If this applies to your client he will want the others to know that he, too, is now having an opinion audit. He might open his comments with, "My CPA said in our last audit. . . ."

Spreading the Gospel

Your client knows that most of the other businessmen in the group have CPAs but he is convinced that his CPA is better than theirs. By persuading his listeners that you are better than their CPAs he will feel he is doing them a favor.

Seeking Confirmation of Judgment

Let us assume that your client, having engaged you, is now wondering whether he made the right choice. Unsure of himself, he seeks to confirm his judgment by persuading others to engage you also. If he succeeds, then their acceptance of you will confirm his own judgment.

Asserting Superiority

Your client is in a group where he feels superior to the others. To prove to himself that he is superior, he tries to persuade them to follow his advice and engage you. If they do, then he will be proving to himself that he is superior and is the leader of the group.

Encouraging Clients to Recommend You

Now that we know the eight situations in which a client might recommend you, what is likely to encourage him to do this? Here are seven suggestions:

1. We must keep in mind that the same client can recommend you in any one of the eight situations depending upon the person or group he is with.
2. Don't be a stuffed shirt. How many stories do you know about CPAs? Not many, I will warrant: there seem to be plenty about doctors and lawyers and other professionals but few about our own profession. The fact that we have not learned to laugh at ourselves leads me to believe that we are not yet a mature profession. While there are few stories that are specifically about CPAs there are a number that can be adapted if you learn to look for them. Don't be afraid to tell him a story which pokes fun at you and your profession but at the same time gets across the point you want.
3. Are you different from other CPAs? If you are, then be sure that he knows about it. If he is made aware of the difference, he is more than likely to use this as the basis for introducing your name into a conversation. Do you attend the AICPA professional development courses?
4. Satisfy his urge for newness. Identify yourself with the changes of the times. Are you using a computer, a service bureau, or perhaps computer-prepared tax returns? If so, tell him about it. We have found this very effective.
5. You must give him something to say. Don't leave him to his own devices, or he may not say the right things about you. In many situations he will start out, "My CPA says. . . ." Now, what is he going to say you said?

   I know that most of you have acquired some proficiency in the art of selling your services. But perhaps you are making the same mistake we made at first: we were not expressing ourselves in a way that encouraged the client to remember and to repeat what we said; we were talking over his head. A client told me one time, "You are certainly very convincing when I talk to you but the trouble is when

I try to tell others about it later, I can't remember how you said it." Every business and profession develops a language of its own which is incomprehensible to the layman. Accountancy is no exception!

So whenever you are talking to a client, you must keep in mind that you are also talking to unseen persons who might be prospective clients. Perhaps it is his golfing partners, a group in the locker room, those at his poker club, or perhaps friends in whom he confides. You must keep in mind these unseen prospective clients and develop a knack for expressing yourself in ways which your client would be most likely to remember and repeat to them.

6. Act as if you want to be recommended. And how do you do that? By your attitude toward your work and your profession. Do you find them interesting and challenging or do you give the impression that your work is dull and tedious, as many suppose it to be? If you observe the preceding five suggestions you can't help but give your clients the right impression.
7. But there is one final suggestion. When you do know that a client has recommended you, thank him. A note or a telephone call is all that is necessary. You are now giving him the biggest emotional kick of all—being appreciated! And if you fail to thank him, you might be leaving him with the impression that you don't care to be recommended.

Dr. Dichter's principles were not known to us until we read his article. Our methods and techniques for expanding our practice, which we have been using for years, had worked even if we didn't know why. Now that we know why and are aware of what must be done if clients are to recommend us, our program will be more effective.

Journal of Accountancy, *March 1970*

Selecting New Clients

Burton S. Moore, Jr.

Recent developments regarding accountant's liability emphasize the need to comply strictly with authoritative pronouncements. A practitioner must be sure a new client will accept these pronouncements and will cooperate in providing documents and supporting evidence.

A practitioner should investigate each prospective new client as to his character, reputation, and honesty. A client with a questionable reputation can mean real trouble for a CPA. He could be looking for someone to prepare statements the way *he* wants them.

Competent professional services cannot be rendered without an adequate fee. Be sure the prospective client is willing to pay reasonable fees and is not merely looking for a low price.

Good work cannot be done on a typewriter stand. If a prospective client is not willing to provide satisfactory working conditions, such as space, equipment, lighting, etc., then the engagement should be refused.

If the client does not have competent staff, and the company is not in a good financial condition, then the CPA's problems are multiplied; it is difficult to do good work and the fee may be uncollectible. Under some circumstances an engagement of this kind may have to be undertaken. If it is, it should be with full knowledge of the risks.

Journal of Accountancy, *July 1974*

What the Client Expects From Its Auditors

J. A. Parsons

A copy of this outline may be a useful addition to every staff accountant's auditing kit.

I. Remember what your function is.
   A. To audit the *records*.
   B. You are not checking up on people.
   C. If a person feels you are checking on his work, he may be offended. Be sure to explain that you are checking the records in order to express an opinion on the statements and that your procedures are required. This situation is quite common in inventory observations and payroll observations.
   D. Your function may depend on size and quality of the client's accounting staff.
      1. Some clients may view your job as cleaning up the records and making all kinds of adjustments.
      2. Large companies generally have competent accounting departments, and making adjustments is not your goal.

II. The careful analysis of internal controls.
   A. This should not be a general analysis but a specific inquiry as it pertains to that particular industry or company.
   B. Give the company credit for good internal control when tailoring the audit program.
   C. If you discover a situation where there is a breach of internal control or an area where you feel internal control is weak, discuss it with your senior and let him talk to a responsible person if he deems it necessary to do so.

III. Planning.
   A. Careful planning is an important part of any audit.
   B. Your client should be involved in the following processes:
      1. Timing of interim examination.
      2. Timing of confirmations: Allow plenty of time for preparation of special statements (e.g., forest products industry).
      3. Timing of inventory observations: In a large company this is a big job and must be carefully done to ensure that exact dates and times are known. You won't get off to a good start by arriving late for an inventory observation.
      4. Timing of final examination: Client's needs are important—
         - Annual report publication date.
         - 10-K report.
         - Annual meeting date.
   C. Interoffice work should be coordinated through corporate headquarters. Make sure your instructions specify the experience necessary to perform the job. The impressions your people make during these examinations are important. They could bring you new clients.

IV. Coordination.
   A. Your work should not interfere with the client's schedule.
   B. Your presence should be planned to facilitate an efficient audit: Don't come in too early and find yourself in the middle of closing. If you do, you will have to conduct your audit on a piecemeal basis, and you are going to be unwelcome.
   C. Preparation of audit schedules.
      1. Review list at intervals and determine client's ability to prepare on a timely basis.
      2. Many schedules can and should be prepared by client and can be useful for his purposes (e.g., fixed assets, etc.).

V. Refer to last year's work papers, permanent file, and internal control questionnaire before you begin asking a lot of questions.

VI. Remember that the chief accountant, controller, and office manager are busy people. Keep your questions to a minimum. Ask a clerk your question if possible. If you don't get a satisfactory answer, then go to the chief accountant, etc.

VII. Don't be afraid to express your ideas.
   A. Refer to other companies and make other suggestions.
   B. Disagree if you feel your position is valid.

C. Public accounting is a good area to enrich your background.
D. *But*—don't forget there are many ways to accomplish a job, and the client may feel theirs is the best after examining your ideas.

VIII. Don't pick on minor mistakes.
A. No accounting department is perfect.
B. Recognize that there are bound to be some mistakes in the best system.
C. Be tactful when pointing out errors.

IX. Make only necessary copies.

X. Returning records to files.
A. Return all ledgers and journals to their proper places as soon as you are finished with them.
B. Let clerks refile vouchers and contracts.

XI. Confidential records.
A. Salaried payrolls—
1. Don't leave records where they can be seen by unauthorized persons.
2. Client salaries should not be discussed in your office or off the job.
B. Stock purchase programs—same applies.
C. Minutes—same applies.

XII. Client relationships.
A. Maintain a professional image.
B. Be friendly but don't overdo it.
C. Don't be afraid to ask questions:
1. Some answers may appear obvious to client, but you can't be expected to understand everything.
2. You may get some sharp answers, but don't let this dampen your spirit. Remember you have a job to do.
3. If you can't get answers, discuss the situation with your supervisor.
D. Be flexible—we don't expect you to violate any auditing or reporting standards, but remember that you are reporting on the *client's* financial statements. Encourage the client to follow generally accepted reporting standards. Don't insist on minor reclassifications; keep in mind what is material.
E. Personality conflicts—the senior should recognize when personality conflicts exist and do his best to ease the strain.

Journal of Accountancy, *May 1973*

Prepare Your Own Client Bulletin

Richard C. Rea

"I wish I had known that."

"Why didn't you tell me?"

For a long time we were disturbed because these comments were so frequently made by our clients. One solution, we realized, was to publish a bulletin including information our clients might need to know, but preparing such a bulletin on a regular basis seemed to be an overwhelming task. As a result, a long time passed before we did anything about it.

In 1954 a situation developed which we knew would affect a number of our clients, but we were not sure which ones or how many. And to try to make personal contact with them all would have been too time-consuming; so we prepared our first bulletin. It was well received, and we were encouraged to send out others, but we had no idea then that some day we would be sending out no. 218.

As we expected, it was a lot of work at first, but we soon became accustomed to it. We started a file into which we would drop memos or material which might be useful in preparing future bulletins.

Occasionally we got a boost from outside sources. For example, a sales tax examiner for the state of Ohio called our attention to mistakes many small businesses were making and suggested we advise our clients of the proper procedures.

At one point the local social security office, which knew of our bulletin, advised us that they could supply us with all the mailing pieces we needed covering changes in social security taxes and benefits.

Besides informing our clients, we have found the bulletin to be an excellent tool for promoting our firm's services.

We decided that if we wanted our clients to tell others about us we had to give them something to talk about. But how were we to do that?

We came to the conclusion that we must tell them about ourselves, and we now do this in our bulletin.

We discovered that many clients thought of the firm only in terms of the one or two persons with whom they had regular contact. The bulletin helped to overcome that problem.

We use it to introduce new members of our staff. When we attend professional development courses, we tell clients about it. They will then realize that we are keeping up to date and this also helps to explain the need for increased fees.

When a member of our staff deserves recognition we compliment him in the bulletin. Besides impressing the clients, such a mention gives him the personal satisfaction of knowing we appreciate his achievement. This might be passing the CPA examination, being elected president of the Junior Chamber of Commerce, heading up a division in the United Fund drive, or membership on a committee of the Ohio Society of CPAs.

We frequently editorialize, but only when we feel we have a topic of genuine interest to our clients.

If you prepare and publish a client bulletin you will distinguish yourself from the CPAs who won't take the time for this activity, and this could be something your clients would like to tell others, who might be prospective clients.

Over the years we have encouraged other local firms to prepare and send out client bulletins and today we exchange with about 12 firms. We borrow from each other and this helps to make the work of preparation less tedious than in the past.

Some of our colleagues use preprinted sheets and some even have logos and embossed letterheads. But our bulletin is prepared on our offset press on 8½″ × 11″ plain paper. Usually we print on only one side, but once or twice a year there is enough copy to fill both sides.

You should give the idea serious consideration. It is not necessary to send one every month. Quarterly, or even irregularly, is good for a start.

All of us have clients whom we see infrequently, sometimes only once or twice a year. We have found that these clients particularly appreciate our bulletin. It is a monthly reminder that we have not forgotten them, and to paraphrase a well-known television commercial, "Our bulletin is the next best thing to being there."

Journal of Accountancy, *October 1976*

Your Own Client Newsletter

Norman S. Rachlin

Every month we tell all of our clients which tax payments are due, we advise them of tax planning ideas, we alert them to new government requirements, we tell them about estate planning, we invite them to our all-day seminars, and we boast a little about the accomplishments of the people of the firm. We do all of this in a light-hearted, house-organ type of publication—a client newsletter called *Reminders & Comments.*

Why do we publish a monthly newsletter?

- The reminder of tax payments due, in the form of a calendar, shows additional concern on our part for the clients to meet their obligations on a timely basis. (They did initially receive a schedule of payments due with their copy of the tax forms we prepared.)
- We are able to tell all our clients about timely and important topics at the same time. With this medium we can discuss ESOP, for example, and not be concerned about missing one (or more) for whom the information could be important.
- It is an opportunity to publicize the extra effort and extra cost we incur to render quality service (examples—conducting and attending professional seminars, a partner's service on two AICPA committees, another partner's presidency of the local chapter, articles published in professional periodicals, in-house CPE programs).
- It alerts the readers to the variety of services offered by the firm and its expertise in specialized areas. There have been articles on estate planning, tax shelters, foreign taxes, audited reports, recapitalizations, and what to do about treasury stock. There has been publicity about our firm's utilities seminar and a free offer of booklets we have published on year-end tax planning and Florida taxes. (One of the most depressing comments I have ever heard was when I discovered one of our good clients had gone to an attorney for all of his estate planning and he said, "I didn't know you did that kind of work.")

- It is a constant communication link of the three crucial elements of practice success—the clients, the firm, and its personnel. An announcement that a staff man became engaged to a partner's daughter elicited dozens of complimentary telephone calls. Whenever a staff person passes the CPA exam, his or her picture and biography will appear in the paper. A monthly column features the "social" news.
- It reflects the strong team spirit of our personnel (such as our very successful softball team) and the pride we take in who we are and what we do.
- The intangible results in developing and expanding the favorable reputation of the firm have been enormous. Our clients appreciate the extra effort on their behalf and tell others about the uniqueness and quality of our service.

As one of our lawyer clients has commented in a letter: "Wow! What a masterpiece of merchandising."

History

How did this "masterpiece of merchandising" come about? About five years ago one of our regular clients complained that he was not sure that his bookkeeper was making "all the tax payments" on a timely basis and he was concerned about interest, penalty charges, and problems with the IRS, the state, the county, and the city. We compiled a schedule of all tax filings and due dates for him and his corporation. The schedule for each month was typed on a separate sheet of paper and, in making copies for him, we printed the heavy quarterly filing months—January, April, July, and October—on colored paper to stand out. He was delighted with this 12-page package. If he was happy with it, what about our other clients? We began to photocopy a monthly calendar of due dates and send it to all clients before the first of the month. Since the due date schedule covered one side of the paper, we started to use the other side for tax tips, personnel notes, news items, and the like.

Like Topsy, it just grew.

It is now a six-page printed publication, still featuring, as a principal page, the monthly calendar.

Preparation

The monthly newsletter is produced by an editorial board of six people, with a partner serving as editor. The board meets for about an hour each month (between the tenth and fifteenth) to critique the prior issue, decide on articles for the new issue, make the writing assignments, and set the deadline for copy. Assignments are usually handwritten and are done on the staff person's own time. The rewards include a byline and picture in the paper, learning a topic, and being an important part of our team.

Ideas for articles come from many sources—weekly tax services, the weekly IRS bulletin, AICPA publications, tax magazines and business publications, such as *Business Week* or *Money*, the daily newspaper, other newsletters, questions raised by clients, contributions from partners and staff, and material received from financial institutions and stockbrokers. A new material folder becomes the repository of possible articles that come to our attention between editorial board meetings.

Handwritten articles are reviewed by the editor and then typed—a unique production technique in itself. While our two-column per page letter looks like one that is typeset, it is actually all done in-house by our regular typist. We use a machine that allows us to vary type in size and style, to make effective headlines, and to justify the right-hand margin. In short, "camera ready" copy is inexpensively prepared in our own office.

We use the following techniques to make the newsletter readable, interesting and entertaining.

Photographs

We use photographs extensively and find it is important to get at least one on the front page to make it interesting. We keep a photo of each partner and staff person in the personnel files and these are drawn on extensively. A staff person who is handy with a camera has made excellent photos for us at our softball games, seminars, company parties, and staff meetings.

We leave space in our "pasteup" and give the photos (black and white preferred) to the printer who makes the necessary "half-tones" and "strips" them in.

Clip Art

One of the trademarks of our newsletter is the liberal sprinkling of cartoons to illustrate articles and highlight columns. These cartoons come in booklet form, published by subject matter—sports, holidays, crowds, safety, education, etc. Once the clip art, as it is called, is purchased, it belongs to you and can be used in any manner you choose. Such material is available from many art studios.

Rub-offs

Rub-offs can be obtained at most places where art supplies are sold. There are amazingly large catalogues of available rub-offs in alphabets and numbers in varying styles and sizes. Rub-offs also come in borders, signs (arrows, stars, brackets, etc.), and line drawings. As the name implies, the item is rubbed off a clear plastic sheet and onto the newspaper page. Rub-offs copy well in the photo offset process.

After the columns are pasted, the photos, clip art, and rub-offs are added and the pages are submitted to our friendly local printer—a client, of course—who then prints the newsletter by offset.

Mailing

We maintain a mailing list on master sheets that are compatible with our copy equipment. When the newsletter is ready, the master list is automatically printed on mailing labels which are then peeled off and pasted on the mailer panel of the newsletter.

One person is responsible for maintaining the list and all new client and change notices are channeled through this person. Every other year we cull the list by a special mailer and the partners' review.

The present list consists of approximately 2,000 clients and others who have requested copies, including CPAs from all over the country.

We presently exchange newsletters with 40 CPA firms. These exchanges arose from a brief item about our newsletter in the Practitioners Forum of February 1974 and from participation in numerous practice management seminars and conferences during the past three years. A number of the newsletters we receive were started as a direct result of our example and motivation. And we find many of our articles are used by others. We certainly are flattered by this "constructive plagiarism."

Costs

It now costs us about $270 a month to produce our newsletter. This is the printers' charge only and does not include the time spent by the editorial board, the writing, the pasting up, and the mailing.

We believe this to be a modest enough investment to reach our clients every month and to tell them the story we want to convey.

Hints on Getting Started

- Don't start out too ambitiously. You cannot create another *Wall Street Journal* overnight. If you have copy equipment in your office, start out getting it produced that way.
- Consider coming out with your newsletter on a quarterly basis at first. Many firms do not use the calendar concept and publish as they feel necessary to disseminate information to their clients.

- Use a mailing list and keep it current. Include all of your clients, even the smallest ones.
- Consult with a local printer as to his ideas for achieving good graphic results at moderate costs.
- Consider retaining an advertising agency or artist to design your presentation. It is a one-time cost.
- If timeliness is not an important factor, third class mail is economical. Check with your local post office.
- Get others in the firm to participate. Generate team spirit. They love to see their names and pictures in print.

Our publication has been a valuable asset in the development of our firm, and it is hoped that this information will be of some help to you should you decide to pursue a similar course.

Seminars for Clients

James H. Wilson

Have you ever had a client ask if you prepare individual income tax returns or state that he "didn't realize you knew how to handle the tax returns for estates and trusts"? This happened to us enough to make us realize we had done a poor job of informing our clients of the services available within our firm. We have attended seminars where we have been told of the virtues of expanding services to existing clients. But how could we get the message across to our clients?

We publish a client newsletter and a brochure telling of the services available from our firm, but these do not seem to generate enough action. Then our firm started a program of in-house seminars. Each department was asked to prepare and present a seminar based on a topic of general interest to be presented to a specific segment of our clients. We are not a large firm. We have a total of twenty-one people, including six partners. Yet despite its relatively small size, the firm is separated into tax, audit, and data processing departments. The following describes our experiences in presenting seminars for our clients.

The Ground Rules

There are certain ground rules which should be considered regarding the date, the place, and even the time of day of the seminar. It is important to make sure that there are no major conflicts with local community affairs. The time of day also is important. We have held seminars at various times—mid-morning, lunchtime, and early evening. The deciding factor should be the characteristics of the group at whom the subject matter of the seminar is directed.

Planning

In selecting subject matter, we capitalize on expertise within our firm. After the subject has been approved, a group of people is assigned to plan the presentation. A catchy title is employed so that the client's interest in the seminar is immediately stimulated. Then we set the date, an important step in providing motivation, and a time frame within which to get the seminar off the ground. It's better to plan the publicity early and follow through with it. Written invitations should be sent with a return, postpaid card for reservations. Within ten days of the seminar, our secretaries call to verify the reservations or to query those who have not responded. This is necessary because busy executives have a tendency to forget, even after they have made reservations. Let me offer another suggestion: We have found it profitable to invite wives to our estate planning seminars. The wives act as a catalyst in producing action.

Presentation

The formula for a successful seminar should include a presentation that proves valuable to the participant. The client should feel his time has not been wasted. There must be a benefit flowing to the client. We must increase the client's store of knowledge, not only about the particular subject but also about our firm. Handing out attractive material to clients generally makes an impact. We have special folders designed to include the materials to be discussed. In the folder, we place the outline of the seminar, supporting schedules, a note pad imprinted with our firm name, and a pencil. Each client entering the seminar is given a folder, which immediately conveys the idea that the session will be a learning experience.

The seminar must be presented in pleasant surroundings. We engage a meeting room at a private club for ours. This room is large and tables are arranged so clients have room to keep their materials and take notes. We always have a refreshment break midway in the seminar.

Producing Results

How well a seminar is planned and presented may not mean much unless the client is motivated to act. The first series of our seminars was well planned and presented, and we thought extremely successful until we sat back and realized that we had not really motivated any clients to action. There was a missing element. We began utilizing better sales techniques and experienced much more favorable follow-up. The missing ingredient was what salesmen called a "closing device."

At the end of the seminar, we began giving our clients a test covering the subject matter and how it related to each guest individually. It is not complicated, involving approximately only ten questions which can be answered "Yes" or "No." The test is designed so that its replies reflect any areas in which the client may need help. Then we include a card on which clients may request an appointment and further review.

A secretary collects the cards and within two or three days after the seminar we phone the client to set up an appointment. This produced a 50 percent response after our previous two seminars, and we have been so deluged with work that we've been forced to postpone additional seminars until we can complete engagements originating from prior ones.

We do not send out invitations to everyone. We are selective, going over our client lists carefully, keeping in mind the subject to be presented. For example, we gave two programs on estate planning, one for retirees and one for businessmen who were still active.

Because our seminar program is well known to our staff, names are added to our lists throughout the year as we perform our regular work, particularly tax and audit engagements.

Attendance will vary, depending on the subject. At luncheon meetings for businessmen, less than 25 have shown up while as many as 60 participants, including spouses, have come to sessions on estate planning.

The estate planning seminars are entitled "A Plan for Living." The seminar "Everything You Always Wanted to Know About Financial Statements but Were Afraid to Ask" is self-explanatory. The only seminar in which we had an outside speaker, a CPA-attorney, focused on the pension reform act. All other seminars have been conducted by our own staff.

Benefits to the Firm

In summary then, why have seminars? Here are some reasons drawn from our firm's experience:

- They are the most effective and economical way to disseminate information about the firm's capabilities in particular areas of professional knowledge.
- They introduce various personalities and talents which comprise the firm.
- They serve to provide an atmosphere for motivating the client to action.
- They are an excellent way to provide for internal expansion. In other words, they are a good marketing tool. (Marketing takes the rifle approach, zeroing in on one target; public relations spreads its

message, shotgun-style, to a wider audience with no specific service in mind.)

- They promote a general feeling of goodwill between the client and the firm. Clients who previously were stiff and formal became more friendly and open. And that's the name of the game—the development of enthusiastic clients.

Journal of Accountancy, *August 1975*

Ten Ways to Lose Clients

Stanley I. Simkins

1. *Submit client financial statements late.* During my ten years in public accounting, this is the complaint most frequently heard from clients and bankers. Some accounting firms have allowed their client's need for current financial management information to take second place to the CPA firm's desire for profit, thereby maintaining too few personnel to service clients properly.

To some extent, delays can be expected during quarterly and year-end periods, in which case, the less important clients take a back seat to the well paying clients. This may make good business sense to some firms; however, those firms that follow this practice will lose clients and gain a poor reputation.

Moral: If you cannot properly service a client, then be honest enough to take corrective action—even if it means referring the client to another firm.

2. *Do not return client telephone calls within a reasonable amount of time.* This is one practice followed by many accountants, lawyers and bankers. Except in some understandable instances, it is one of the most frustrating and rude practices encountered in business. Certainly, we are all under time pressures. Understandably, many of us are not always able to return calls promptly. However, many of us do not always try to return telephone calls the same day. We often feel, "It can wait until tommorrow," while the client stews with what seems to him to be an urgent problem.

Moral: Continue this practice and maybe your client will find somebody who can spare him some time.

3. *Do not be available when client needs you.* One of the characteristics of public accounting is the personal sacrifice of time required for the practitioner to service clients properly. Although it makes sense to

schedule all meetings during business hours and to try to even out one's work load, anyone in public practice knows that clients cannot predict their periods of crisis and professional need. Consequently, when a client asks for your help, he expects you to be available within a reasonable period. Many practitioners have a work load which limits their ability to satisfy their clients' demands. Of course, some conflicts cannot be worked out easily, but there is little excuse for the practitioner who does not make an honest effort to meet his clients' needs.

Moral: If you know how angry you would be if your doctor did not have time to see you, then you can guess how a client feels when you don't have time to see him.

4. *Surprise the client with an unexpected fee.* We all know that clients are more conscious than ever about soaring costs—including accounting fees. However, some practitioners still feel that because they are professionals they can render invoices for services without discussing, in advance, the scope of an engagement and the fee arrangement. It is poor practice to accept an engagement without giving the client some idea of the fee.

Moral: It is better to prepare a client in advance than to shock him with a fee of twice what he expected.

5. *Provide poor tax planning.* This practice is accomplished by omission rather than commission. The practitioner who follows this rule does not consider each client's financial and tax planning alternatives. He does not keep abreast of current changes, new techniques, or even established practices. His problem is not necessarily a matter of technical competence, but may be one of attitude. The practitioner who is happy with his practice and who enjoys a good relationship with his clients will usually not have this problem.

Moral: Make believe that your client's money is your own and provide appropriate planning advice.

6. *Abuse the client's telephone.* A characteristic of the accounting profession is the need to work at a client's office. Consequently, it is the practitioner's point of contact for telephone messages. However, some accountants lose sight of the fact that they are being paid to service a particular client—not to establish a field office at the client's place of business. Often a practitioner will spend too much time on the telephone when calls could be handled at another time and place.

Moral: It is unfair to allow telephone calls to interrupt meetings or client services.

7. *Practice "habit accounting."* This technique prevails when the practitioner does the "same old thing" over and over. He shows lit-

tle, if any, personal interest in the client's affairs. He is too much like a bookkeeper rather than a "business doctor." He avoids becoming involved in solving operation problems.

Clients are seeking more guidance from their accountants. This should be an opportunity—not a threat.

Moral: Survival of the fittest applies to the accounting profession as well as any other enterprise. Now is the time to perform as we are expected to.

8. *Assign staff personnel who do not possess adequate technical training and experience.* Although it should not even be suggested that a firm would knowingly violate a standard of field work, it is a fact that we often lose sight of the requirements of an assignment when under the pressure of a manpower shortage. Consequently, we sometimes close our eyes and hope that a less than adequate staff person will be able to handle an assignment that is beyond his training and experience. This shortchanges not only the client, but also the firm in many ways: it can be demoralizing for the staff person; it can result in excessive time to perform certain tasks; and it can expose the firm to potential malpractice suits.

Moral: Adequate attention should be given to scheduling and assigning staff people. "Making do" without adequate supervision is a kiss of death to client relations. Even the unsophisticated client will recognize this situation.

9. *Allow the client to miss payment of tax deposits.* Most accountants send instructions to their clients regarding tax payments for personal and corporate income taxes. However, most rely on the client's personnel to remember other payments. It is advisable to establish some method for ensuring that all payments are made on time. Even though this would appear to be the client's responsibility, we can avoid ill feelings on the part of the client who believes it is his accounting firm's responsibility.

Moral: "An ounce of prevention is worth a pound of cure."

10. *Discuss your clients' affairs in close quarters in public.* There is no doubt in my mind that few practitioners discuss client affairs in conscious violation of the AICPA Code of Ethics. However, some of them sometimes forget themselves when with other firm members in public places.

Moral: Once a client believes you have betrayed his confidence, you are useless to him.

I am sure that many readers could add to this list a few more ways to lose clients. I hope this article will stimulate readers to take a closer look at their own practices.

3

Staff Recruiting, Training, and Administration

Successful Small Firm Recruiting

Jeffrey D. Knezel

When attending meetings with small firm practitioners from all over the country, I often have the opportunity to discuss recruiting practices. More often than not, I hear the complaint that the small firm just isn't able to compete with the regional and national firms when it comes to recruiting the top students. I believe that the small firm can not only compete with larger firms but may also have some advantages over them. Here is a description of the recruiting efforts made by our firm.

We are located in Appleton, Wisconsin, a city of approximately 60,000, and have one office with a staff of about 35, including owners. Recruiting is the responsibility of our personnel committee, which consists of two stockholders.

Our initial approach is to select two or three of the best accounting schools in the state. We meet with the dean and key accounting professors at each school. This contact is essential since the college staff members can have a major influence on the employment decisions of the students. The accounting staff is encouraged to visit our office to learn about our firm.

We further strengthen the school's familiarity with us by supporting the various accounting student organizations on campus, such as Beta Alpha Psi, accounting clubs, and the like. Often these organizations will meet with public accounting firms, and we make a special effort to attend and support these meetings. These functions offer the additional opportunity to meet in advance many of the students who will be interviewing later in the year.

About three or four weeks before the interviews, we make a trip to the college for the purpose of reviewing student academic files. This enables us to become better acquainted with the students and to initially select those on whom we wish to concentrate. On that trip, we also schedule luncheon meetings with some of the school's accounting staff to discuss the students and obtain recommendations as to which ones might best be suited to our relatively small firm. After a day or two at the school, we compile a list of 10 to 15 students to whom we direct our primary recruiting efforts.

The next step is either to telephone or write personal letters to each of them expressing our interest in them as possible employees. In this contact, we encourage them to sign up on our interview sheets or for separate interviews. We try to personalize each contact with information gleaned from the student files and from discussions with the accounting staff. We wish to show the students our genuine interest in them as potential employees.

During the on-campus interview, we make a special effort to sell the advantages of working in our location. We talk about the high quality of life in our community and emphasize the social and cultural activities that are within a reasonable driving distance. We readily admit to some of the standard small firm disadvantages, but also note the compensations for these disadvantages. Finally, we point out any unique facets of our firm compared with other local and regional as well as national firms. Our firm happens to be a service corporation, so we emphasize the opportunities for ownership through the gradual purchase of stock beginning fairly early in their careers.

Following the interviews, our personnel committee selects those students we wish to invite for an office visit. When arranging for interviews, we request the candidates to bring their spouses or fiancees along. We emphasize that the spouse as well as the candidate needs to be happy and comfortable in the living situation. During the office visit, we arrange to have someone show the visiting spouses around our city. They are shown the shopping areas, available housing and generally given a tour of the community.

We try to have all the owners of our firm meet with the candidates to indicate our interest in them. We allow time for the candidate to talk with some of our junior staff members as well as the owners of our firm. During the office tour, we emphasize that the candidate, if hired, would have his own desk and work area, possibly even a separate office or shared office, and access to the professional library. We demonstrate our firm's organization by showing the candidate such items as our personnel and audit manuals, routing sheets, and tax library. We emphasize the variety of work that we do in all the major areas of practice, not just auditing. The candidate is assured that early in his career he will be assigned to a variety of jobs so he may select an area of speciality after wide experience.

After completing office visits, the personnel committee then selects those candidates to whom we wish to offer employment. We personally contact each candidate and describe the terms of our employment offer and try to answer any remaining questions which might have come up. We offer assistance in locating proper housing, suggest job possibilities for the spouse, and so on. The professionalism existing in the firm is reemphasized at this time, but we also try to show the candidates that we are genuinely interested in them as friends as well as fellow accountants.

In special cases, we go one step further in the recruiting process. We ask the candidate to meet with a professional psychologist to discuss career objectives and viewpoints. The psychologist is closely attuned to the personalities and work situation within our firm and can often detect possible conflicts of personality; he also can identify strengths and weaknesses in a candidate's skill level. We currently utilize the psychologist primarily for hiring experienced professionals or paraprofessionals. However, I believe that a wider application of this method could be made for recruiting new college graduates. In most cases, the candidates are impressed with the degree of effort we expend to find qualified people.

As to compensation and fringe benefits, it is our belief that, while making a competitive offer, the additional effort described above will make the difference in securing the best people.

Recruiting Brochures for the Small Firms

Theodore Cohn

Recruiting brochures are discussed at length in the Management of an Accounting Practice Handbook, *section 302.05. A suggested outline for such a brochure is also given. However, readers may be interested in seeing the following text of such a brochure.*

The Company

Our company was organized in 1919 and has grown steadily since then. Within the public accounting profession we are classified as a medium-sized regional firm. Our growth can be traced to the high standards we have always adhered to and the variety of services we offer our clients. We have had to enlarge our staff through the years not only to handle new engagements but to keep up with the growth of established clients and the offering of new services. Accordingly, every member of our staff has shared in the growing opportunities of our increasing practice as evidenced by our staff's widening experience, broadening responsibilities and increasing relative remuneration. Our growth in the past five years is reflected in the opening of two new offices and the doubling of our personnel.

Our staff presently consists of approximately 65 field auditors, 12 members of the tax department, a management services department of 3, and review and management personnel. There are sixteen partners and nine managers.

The Environment

The simplest way to define the working atmosphere of our company is to say it is rational. Work, supplemented by guidance from strongly established principles of management, is the primary determinant of daily activities. Each of the firm's principals—whether a partner or manager—is deeply experienced in the company's work and has risen through the ranks solely by the force of his own efforts and competence. Accordingly, each principal brings to his responsibilities the understanding and respect that makes possible a high quality of service.

The staff of our company forms a whole from the viewpoint of technical capacity and sharing of knowledge. No person is admitted to the firm who does not have an inherently high ability; no member of the firm lacks interest in sharing information and knowledge. Next to client services, development of our people and utilization of their best and newest capacities are the firm's topmost objectives.

Personal Growth

Advancement has always been rapid for members of our firm determined to accept and handle increased responsibility. We actively seek to find and reward progress and this is demonstrated by the fact that advancement to senior accountant status is faster with us than with other firms approximately our size. Length of service is not a factor in promotion; performance is the only criterion. Since advancement takes place primarily within the firm, we add to our staff mainly at the junior and semisenior levels.

Professional Training

The training of new staff members is a matter of first importance to every member of our firm. We have almost fifty years of evidence that constant training is required to maintain the quality levels we insist on. Accordingly, every member of our staff spends a part of his time giving and receiving instruction.

We feel that the greatest benefit to new personnel is derived from training on the job. Our experience tells us that formal training immediately upon hiring is not as effective as field experience followed by selective formal training.

The formal training of a new staff member proceeds as follows:

1. *Orientation.* First few days spent in office for familiarization with firm procedures and personnel policies, general orientation and review of working papers and staff manual.
2. *Initial.* Intensive review of selected audit steps and working paper presentation given after approximately three months of field training when staff member has had practical experience against which to compare theoretical doctrines.
3. *Periodic.* Seminars and discussion groups in auditing procedures, report writing, business problems, tax planning, etc.

4. *Special.* Lectures to explain tax law revisions and major pronouncements of the AICPA.

These training phases last from a few hours to several days. Training in our firm does not end with indoctrination; it is continual and never completed. The fund of usable knowledge is continually being enlarged with influxes of new information gathered from outside and distributed internally through the many means we employ to keep our staff equal to their responsibilities.

Our partners and staff are in themselves our best training asset. Among them are members who hold offices in the AICPA and various state CPA societies and other professional, accounting, and financial organizations. They have written many articles for professional and industrial publications and have led professional training courses.

In one three-month period recently, we conducted formal training sessions on workpaper preparation, audit procedures of inventories and receivables, preparation of personal and corporate tax returns, contents of long-form reports, methods of insurance coverage, business problems of clients and tax planning for closely held corporations.

We have an extensive library of accounting and other professional literature available for reference and as an aid in additional studies.

Specialization

The members of our staff who wish to specialize are helped to do so, but not at the expense of staff members who wish to continue as generalists. Although we have a large and capable tax department, for example, our staff auditors prepare tax returns and represent clients in negotiations with the Internal Revenue Service. They consult with the tax staff when major tax planning is necessary. Our specialists work with colleagues rather than around them. Staff members planning to become specialists may move into our tax or management services department. Specialization generally starts after the staff member has become a well-rounded auditor—usually after about two to four years.

Evaluation

A formal review, aided by evaluations and ratings by the partners, managers and seniors, of each member's performance and salary is conducted twice each year. Review is followed by an individual conference between the staff member and the managing or personnel partner, the purpose of which is to aid individual growth through constructive recommendations, refinement of goals, personal development, salary discussion and planning for improvement in experience and opportunity in the succeeding six-month period.

One possible result of this highly individual evaluation procedure is that for approximately fifteen years no one has left the firm for another public accounting firm because of dissatisfaction with his salary or professional growth and opportunities.

Travel

Average travel time for the staff is 5–10 percent. Each trip is seldom for more than a week. We try to give special consideration to those staff members who request more or less travel than the average.

General

We do not engage temporary personnel during our "tax" or "busy" season. Each person is hired with the expectation that he will become part of our permanent staff or will have dealings with us for many years. A sizable number of the financial executives we deal with are former employees of ours. Relations with them are among the very best we have with client personnel.

Impending military service does not eliminate an applicant from our consideration. Our staff is large enough and our practice dynamic enough that a qualified applicant is welcome even though his service with us may be interrupted by active military duty. We consider such duty as a temporary leave of absence.

We encourage staff to advance their education through local colleges or by attending specialized courses. Presently, members of our staff are enrolled in law school, graduate school (toward MBA), IBM courses, accounting systems courses, report writing courses, etc. Where the interests of the firm are served, we bear all or part of the costs of attendance. Approval of school attendance is given by the partner in charge of personnel.

Our widely diversified practice includes clients in many branches of manufacturing, retail, wholesale, financial, real estate and brokerage businesses. In addition to regular audit and tax work, we conduct engagements in the fields of systems, costs, budgets, and special investigations. While our practice is largely in the Newark and New York metropolitan areas, we serve clients all across the country.

Another type of diversification is in the size of our clients. While most of our services are performed for medium-sized businesses, we audit both large national companies and small local businesses. Our assignment policies give our staff the opportunity to perform phases of involved audits on one engagement and, on the next, to complete the entire audit including the financial statements and tax returns.

In an average six-month period, a staff member will be assigned to about 20 different engagements and work under ten supervisors.

Personnel Policies

Salary scale comparable with that of other medium-sized firms.

Overtime: 1½ times regular rate.

Manager's participation in firm's earnings.

Pension plan and death benefits: paid entirely by the firm (approximate contribution is 5 percent of annual salary).

Vacation: two weeks after one year's service; three weeks after five years' service.

Fringe benefit program, substantially paid for by the firm:
- Group life insurance.
- Group medical-surgical insurance.
- Group hospitalization insurance.
- Long-term disability insurance.

Major medical expense insurance.

Travel insurance policy: $50,000.

Reimbursement of commutation expenses.

Payment of dues to professional societies and cost of attendance at meetings.

Reimbursement of cost of CPA examination to successful candidates.

Rotation of personnel on engagements to widen experience.

Equal opportunity employer.

Journal of Accountancy, *July 1971*

Three-Dimensional Staff Development

William G. Shenkir and Thomas L. Wheelen

Every new staff member of a CPA firm is a potential partner. In some cases, potentiality may not become actuality because of improper management development. It is essential to the continuation of a CPA firm to recognize that partners are not born or preordained but developed. The question is: What strategy is necessary to ensure proper development of each staff member's potential partnership abilities?

In a classic article ("Skills of an Effective Administrator") which appeared in the January-February 1955 *Harvard Business Review,* Robert L. Katz delineated three skills needed by an effective administrator. These skills are technical, human, and conceptual. They must be developed as a staff member progresses in a CPA firm. Staff professional development should concentrate on all three of these dimensions. According to Mr. Katz, ". . . a skill implies an ability which can be developed, not necessarily inborn, and which is manifested in performance, not merely in potential."

Technical Skill

For the CPA, technical skill relates to the performance of accounting, auditing, tax, or management advisory services for clients. The passing of the CPA examination is an indication of the individual's technical skill. Once having passed the examination, the CPA has readily available opportunities for further development of technical skills. Immediately, one thinks of the extensive professional development offerings of the American Institute of CPAs. A CPA, as he progresses within a firm, can maintain his technical competence. Actually, the CPA does not have a choice in the matter, for the first general auditing standard states: "The examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor." With the "knowledge explosion," technical competence is not a static condition.

Hence, to meet this auditing standard a firm must organize a program of continuous professional development for its staff. Such a program, in addition to formal courses, should include regular staff seminars on technical subjects. Also, technical skills of staff members can be developed through the evaluation of their work after the completion of an audit assignment and through rotation of job assignments in their early years as auditors. Frequently the workpaper review process takes on negative connotations instead of being viewed as a positive medium for improving technical skill. Since CPAs have an excellent history of maintaining their technical skill, further elaboration of this dimension of staff development does not seem necessary.

Human Skill

For the CPA, skills of two kinds are needed—internal and external. For the internal, the human skill relates to the CPA as a member of a firm and, more specifically, of an audit staff assigned to a given engagement. This skill includes the ability to work with people and the cooperative spirit necessary in group work. Auditing is, in effect, a group task, and a CPA must possess the ability to get along with the other members on the assignment. If he finds himself in charge of a specific segment of the audit or the entire engagement, he must be sensitive to the opinions and feelings of the other members of the audit team. As a supervisor or manager, he should strive to create an atmosphere where subordinates will be motivated to offer their opinions on how best to perform the assignment. Staff members can offer suggestions which might lead to new audit steps or to the deletion of those which were not necessary but had traditionally been performed. The creation of an atmosphere which is conducive and receptive to the ideas of new staff members involves the use of human skills.

The external skill—relationships with people outside the firm—is needed in the application of the audit evidence gathering techniques. The actual application of such audit techniques as physical examination and count, examination of authoritative documents, retracing of bookkeeping procedures, inquiry, examination of subsidiary records, and observation of pertinent activities brings the auditor into contact with the client's personnel. Many of the client's employees have a definite fear of auditors and must be handled with the utmost tact. The many requests made of the client's employees by the auditor call for exceptional human skill. In addition, the CPA deals with other professionals such as lawyers and internal revenue agents where the human skill is vital.

Given the need for the human skill, how can the CPA develop this skill? The traditional accounting undergraduate program probably did not do all that was possible to enhance this skill. With the advent of the emphasis upon the behavioral sciences—anthropology, psychology, and sociology—most accounting majors are being exposed to subject matter which focuses upon this skill. Additionally, the teaching media used today, such as the case method and business games, involve participation and small-group work and develop this skill along with the technical skill.

Once with a firm, the CPA can develop the skill through formal courses, staff seminars, and on-the-job experience and evaluation. The AICPA's staff training programs direct attention to this skill. The sensitivity training courses (T-groups) offered by various professional training organizations are aimed at this skill. On a staff level, a firm can have seminars occasionally dealing with human problems and can use the case method, role playing, and incident methods. During an audit engagement, staff members can be observed and their ability to work with others evaluated.

Conceptual Skill

The conceptual skill relates to the ability to see a business entity in totality—to recognize how decisions in one area affect the overall corporate strategy. The auditor should not merely audit the books, but he should approach the audit with a philosophy that he is auditing the business. The need for the conceptual skill is implied in the notion of "total service" (auditing, tax, and management advisory services) which CPA firms offer to clients.

The conceptual skill will become increasingly more important as CPAs spend more of their time advising management. In discussing the future role of the CPA in this area, the statement has been made that "the CPA firm will have to look at a client's business as a whole—much as a competent physician examines the whole patient before diagnosing or prescribing for a local ailment" (John L. Carey, *The CPA Plans for the Future,* AICPA, 1965, p. 260).

A basic ingredient of the conceptual skill is creative ability. Certainly, the CPA, as he advances in a firm and takes on more client responsibilities, will have to exhibit his creative conceptual skill. Development of the conceptual skill can be enhanced through formal courses directed toward general management problems such as those found in the executive development programs offered by many universities. A special CPA executive development program is also a possibility.

Conclusion

The typical auditing hierarchy is junior, senior, manager, and partner. At the entry level the technical skill is most important with the human skill also very critical. At the junior level, the conceptual skill is least important. As the junior auditor progresses, technical skill in auditing and accounting is more or less taken for granted, and the conceptual skill becomes more important coupled with the always present need for the human skill.

Recognizing the skills needed at various staff levels, CPA firms should organize their professional learning experience to assist staff members in developing them. Actually, the three skills are often interwoven and many attempts at developing these skills can be accomplished jointly. Thinking in terms of skills rather than traits necessary for a CPA to become a partner should provide for an improved evaluation process of subordinates. When a person has improved in a skill, it will be revealed in improved performance. Traits are elusive and difficult, if not impossible, to evaluate.

Journal of Accountancy, *February 1970*

Who Trains Your Juniors?

Richard C. Rea

You will probably be the most influential person in a new junior's career if he is taking his first job with you. If you are unable or unwilling to develop the skills your new junior needs to succeed in our profession, he will set lower standards for himself than he is capable of achieving; his self-confidence will be impaired; and he will develop negative attitudes toward you, his job, and, in all probability, his career. If he decides his chances of building a successful career with you are declining, and he does have high aspirations for himself, he will leave you hoping to find a better opportunity.

An article in the *Harvard Business Review* of July-August 1969, by J. Sterling Livingston, entitled "Pygmalion in Management," makes some keen observations concerning the effectiveness of a new junior's first boss.

A unique characteristic of successful trainers, Livingston says, is their ability to create high performance expectations that juniors can fulfill. But most of you unintentionally treat a junior in a way that leads to a lower performance than he is capable of achieving. The way you treat him is subtly influenced by what you expect of him. If your expectations are high, productivity is likely to be excellent. If your expectations are low, productivity is likely to be poor. Juniors, more often than not, will deliver the kind of performance they believe you expect of them.

You cannot avoid the depressing cycle of events that flow from low expectations merely by hiding your feelings from juniors. If you *believe* a junior will perform poorly, it is virtually impossible for you to mask your expectations, because the message is communicated without conscious action by you. Indeed you often communicate most when you believe you are communicating least. If you say nothing, the junior can take your silence to mean you are displeased with him or believe he is hopeless. The silent treatment communicates negative feelings even more effectively, at times, than a tongue lashing does. What seems to be critical is not what you *say,* but the way you *behave.* Indifference and noncommittal treatment, more often than not, will override what you say, communicating low expectations and leading to poor performance.

Livingston says we are more effective in communicating low expectations than high expectations, even though we believe the opposite. It is difficult to recognize the clarity with which we transmit negative feelings.

Your expectations must pass the test of reality before they can be translated into performance. Juniors will be motivated to reach high levels of productivity only when they consider the boss's expectations to be realistic and within their reach. If they are encouraged to strive for unattainable goals, they eventually give up and settle for results that are lower than they are capable of achieving. No motivation or response is aroused when the junior sees the goal as being either certain on the one hand or impossible to attain on the other. If he fails to meet performance expectations that are too high he will lower his goals; his performance will drop off and he will develop negative attitudes toward his work. It is therefore not surprising that failure of juniors to meet unrealistically high expectations can lead to resignations, just the same as low expectations.

Livingston tells us that successful trainers must have confidence *in their own ability* to develop the talents of their juniors. Contrary to what might be assumed, the high expectations of superior trainers are based primarily on what they *think about themselves*—about their ability to train and motivate juniors. What the trainer believes about himself influences what he believes about them, what he expects of them, and how he treats them. If he has confidence in his own ability he will expect much of them and will treat them with confidence; but if he has doubts about his own ability he will expect less of them and will treat them with less confidence.

Stated in another way, the superior trainer's record of success and his confidence *in his own ability* gives his expectations *credibility.* As a result, his juniors will accept his expectations as realistic and try hard to achieve them.

Your expectations have the most magical influence on young people. As they mature, their self-image gradually hardens, and they begin to see themselves not in the light of what they could do, but only in the light of what they have done. Their own aspirations become increasingly controlled by the reality of their past performance. It becomes more and more difficult for them, and for you, to generate mutually high expectations unless they do have past records that are outstanding.

Unfortunately new juniors rarely work closely with experienced trainers. Normally they are bossed by seniors who lack the knowledge and the skill required to develop the capabilities of new juniors; they give up easily, believing that the inadequacy is that of the junior and *not of themselves.* As a consequence, many juniors begin their careers in public accounting under the worst possible conditions.

Although most of us have not yet recognized the problem, our profession's greatest challenge by far is the underdevelopment, underutilization, and ineffective management and use of our most valuable resource, our young professional talent.

For you who are concerned with the productivity of your organization and the careers of young employees the challenge is clear; you must develop the ability to train juniors in ways that lead to high performance and career satisfaction. You not only shape the expectations and productivity of your juniors, but also influence their attitudes toward you, their jobs, and themselves. If you are unskilled, you leave scars on the careers of these young people, cut deeply into their self-esteem, and distort their image of themselves. But if you are skillful and have high expectations of them, their self-confidence will grow, their capabilities will develop, their productivity will be high, and they will generate profits for you and themselves.

Journal of Accountancy, *February 1972*

Make Way for the Managers of the Future

Richard C. Rea

The ambitions and objectives of the students graduating from college today often bear little resemblance to the long-term plans of their counterparts of only a few years ago. Their life styles and their attitudes toward their careers will require many firms to readjust their organizational patterns; otherwise many of these younger people may become permanently lost to the profession if it appears to be irrelevant to their objectives or if they believe it would subordinate their identities and misdirect their energies. Firms that do not or will not respond to their needs will be running a risk whose severity is likely to be masked by its lack of immediacy. Some may work for a firm for some time before they leave.

Mack Hanan, managing director of Hanan and Son, New York managing consultants, in an article in the July-August 1971 issue of the *Harvard Business Review,* "Make Way for the New Organization Man," believes that this nonresponse could show up during recruiting. Either the most desirable recruits will not apply at all or will refuse job offers once they are made.

These new graduates are motivated by values which are, in many respects, polar opposites of those of the past. While magnitude in an enterprise was once admired, the recruit will often search out newer, smaller firms where he believes "it's not so dull as the big firms and it will be easy for me to do my own thing."

Many of these young people are beginning their careers with the expectation of changing the character of the firms for whom they are working. Ways must be found to provide what has been called "a tolerable compromise" between the aspirations for diverse, challenging work and their desire to serve worthy causes. As a result they will press for firm-sponsored activities in community development, minority education, and environmental control, which can accomplish worthwhile work and at the same time advance their professional careers. Many of these young people come to their careers with a lesson they have derived from their college experiences, local political organizations, or the armed services—namely that intelligent, consistent dialogue can accelerate institutional change. They want to see this same running dialogue within their firms to find out how the firms are being operated and to gain opportunities to see their own views put into practice in issues of firm policy.

Moreover, because these young people have been in the forefront of change, their time frame for waiting it out in the organizational environment has been considerably reduced; and so accordingly has their satisfaction with receiving merely token offerings.

Another major difference concerns the ways in which these young people want to maximize the rewards from participation. They want to share in personal benefits of leadership, and also to share in the organization's equity which they define—at least in part—as a return on their contribution.

Without question these new differences can create serious problems. As one executive said, "From what I understand, a firm which wants to grow is going to have to put its newer people into bigger jobs and fast. We have been assured that they can manage jobs because premium is on knowledge and not experience—and these young people have the knowledge or know where to get it. Furthermore, they believe that older men like me supposedly could not do the work as well because we have the wrong conditioned reflexes. Now, speaking personally, one of my own long-standing reflexes is against putting young people into big jobs, so where does that leave us? Well, it is going to leave all of us in a very difficult and dangerous situation unless we recognize this trend of the future and start now taking steps to meet it."

Hanan has put together a minimal system of three categories of response to the problems of styling today's business to this future type of management. The system described is to be called minimal since it represents the smallest number of major adjustments which appear to be necessary. These are—

- Personal involvement. Making use of new forms of equity participation, management representation, and decentralization of managerial authority.
- Collaborative leaderships. Emphasizing the joint exercise of authority and innovative approaches to goal setting and achievement.
- Self-fulfillment options. Centering on invigoration of individual rights within the framework and on setting up "fast track" recognition for excellence.

But, Hanan tells us, even with this minimal system there are strategic adjustments which must be considered.

Equity Participation

They must be able to see, fairly early in their careers, an opportunity to have a "piece of the action." This might be accomplished by earlier profit-sharing policies than have been the pattern in the past, or, perhaps even better, extending some form of partnership status to lower levels than have been customary.

Management Representation

Many organizations, colleges and universities, political units, government organizations, community organizations, and even the corporate boards of large industries are recognizing the need of giving younger people some participation at the top organizational levels. Accounting firms should consider some type of organizational change to recognize this trend.

Decentralization

These young people may become a paradoxical breed of manager in the future. They are not entrepreneurial enough to start their own practice, but are too entrepreneurial to be satisfied with most of the administrative or custodial tasks of a firm such as operating existing organizations with the objective of maintaining the status quo. They prefer to remain with a firm, but at the same time want to be as autonomous as possible and run some office, department, or division as if it were their own.

Mutual Responsibility

For most managers, leadership means commanding a position out in front or up above the group: a "superior" position. The new type of future manager will not be satisfied with this arrangement and will want to level off the organization so it tends to operate more on a horizontal than a vertical pattern. They want to be able to get to the man at the top; at the same time, they want him to get with them. They want leadership to exercise from the midst of the group with its influence radiating outward rather than downward.

The effect of this approach will be to distinguish the leader primarily as being the person who is most responsible on a team of mutually responsible collaborators. Rather than giving commands and demanding obedience, he will be expected to issue guidelines and stimulate the group to fill them in with him. His chief tool will be negotiation and persuasion, and his principal capability catalytic and motivational.

Innovation-Mindedness

These new organization people are turned on by the leader's ability to manage ideas rather than by his ability to manage people. They look on the old style concepts of managing people as manipulation: using others for self-aggrandizement. Conversely, they see managing ideas as a major justification of leadership. Because these new juniors are highly experimental, they will expect their leaders to be, too. They reject sacred cows, wait-and-see attitudes, and the need for complete unanimity before moving ahead. The managers of the future will therefore define their leader as one who gets things done innovatively.

Individual Rights

These young people will be more concerned with securing their rights than discharging their responsibilities. They are aware that responsibilities have always been rather clearly defined in organizations, while individual rights have too often been spelled out one at a time. As one manager said: "You learn your responsibilities as soon as you join the firm, but you earn the knowledge of your rights one by one over many years. They don't exist anywhere; you have to sense them out. If you sense wrong, or if you sense too much too soon, that's it; you suddenly have another responsibility—to find a new job."

Tenure

These new managers will not desire tenure agreements, in contrast to their predecessors, for the sake of security. They base their security on their knowledge and motivation. Nor are they interested in tenure as a means of belonging. They consider tenure as an important element in their own personal long-range career planning process that allows them to plan for self-development. To them it also implies accomplishment, measurable over a relatively short period of time on a "produce or get out" basis. They would like to see tenure by accomplishment as proof of their contribution to the success of the organization. The type of tenure they desire is the opposite of time serving or promotion based on seniority. Since management by objectives is important to them in their professional careers, their accomplishments of specific objectives by virtue of their managing ability is equally important to their sense of personal achievement. Again, an earlier partnership opportunity would tend to satisfy this need.

"Fast Tracks"

These young people are in a hurry. To hold them, firms must provide greater advancement opportunities and be ready to recognize any individual achievement. This means successful firms will have to determine priority ranking for the opportunity areas, and will be forced to create additional growth prospects if the existing opportunities cannot measure up to the emphasis these people will place on "fast tracking."

Serious self-analysis may reveal a deficit of true growth potential for many accounting firms. The discovery that the firm has more slow tracks than fast tracks, or that a lot of tracking terminates, or dead ends, or runs across unguarded grade crossings will stimulate a firm to prepare for new growth in a timely fashion.

In conclusion, top management must contemplate how it will adjust to meet the personal and professional needs of these new young people. It will have to discover that one of the results will be horizontal rather than vertical management. The key issue of this next decade may well be the recognition of the horizontal type organization for firm growth.

Horizontally organized firms will discover that decentralization can be achieved more easily. Greater emphasis can then be placed on profits since each unit, no matter how small, can be organized as a profit center. Each center will be forced to concentrate on compromising its profitability, and these smaller profit centers can also serve to provide "fast tracks," which will attract the most able among recruits. These profit centers will also give the managers a powerful stimulant to exercise their talents in innovative ways.

Finally, the horizontal organization, decentralized with profit centering, can help increase the rest of involvement in social activities that are both philanthropic and professional in nature. Accountants are, after all, in a good position to become conscious of social needs, and the new informal type of working environment favored by these people can serve these needs often during what would normally be considered their own time.

Journal of Accountancy, *April 1971*

How the Results of an Attitude Survey Brought Change

Theodore Cohn

As our firm has grown, we have had the feeling that those of us involved in its management were no longer aware of the opinions, both positive and negative, of many members of the staff. We had, of course, certain indexes of attitudes in the form of low turnover statistics, specific complaints, willingness or unwillingness to work difficult hours, recommendations from members of the staff that their friends come to work with us, and comments made in individual semiannual evaluation sessions. At the same time, we felt that we were ignorant of the staff's attitudes on many areas of the firm's operations.

With this in mind, we adapted the attitude survey prepared by the California Society of CPAs, and conducted it anonymously. Although we asked for identifying data on age, number of years in the profession, department of the firm, etc., we urged the staff to omit anything that would reveal identity.

We disseminated the results by giving the number of each answer for each one of the 34 questions. We also reported the specific areas of the firm's operations that the attitude survey had indicated could bear improvement. These were: communication, fringe benefits, and our training program. Incidentally, diversity of experiences, challenge, and people were what was most liked about the profession. The firm's strong points were its high professional standards; informality; freedom and responsibility; chance for advancement; and helpful staff. Overtime, pressure of deadlines, and work that was sometimes not challenging were the dislikes for both the profession and the firm but seemed to be understood as being largely beyond control.

Based on the attitude survey we expanded our internal communication by the installation of a biweekly news bulletin distributed with the pay checks. This bulletin includes all the normal firm information on personnel and client changes, births, marriages, baseball team results, training programs, articles and speeches before professional groups, and an occasional short exhortatory piece on auditing or accounting standards.

As for the fringe benefit program, further questioning of a random group of people disclosed that the problem was not so much the coverages provided but the communication concerning the benefits and their administration. We have taken steps to revise the fringe benefit program manual, are planning meetings for open discussion, and are in the process of a broad review of the total program, an announcement of which was made to the staff in its planning stage.

Finally, our training program which had been somewhat informal was strengthened through a core of 15 days of formal training scheduled one day a week starting in July. These are all-day sessions run by different members of the staff under the direction of an assistant professor from a local graduate school of business administration.

An audit manual is being edited to make it more practical for field use. We are expanding opportunities to attend AICPA and state society courses. A monthly bulletin discusses our time-sharing terminal and we have completed the first CPA review course run by the firm. Organized by one of our audit managers, this program is given two evenings a week, two hours each evening, and deals with auditing, theory and accounting problems. Partners and managers run it; attendance is voluntary but high.

Although it is hard to tell whether these efforts have resulted in discernible improvements in overall staff attitudes or in the areas attacked, we feel that the firm has benefited from the results of the attitude survey and, even more important, by the steps we took to solve the weaknesses revealed.

We plan to repeat the survey next spring and make it an annual procedure so that we can measure change.

For those who might be interested in using the survey, we recommend that you tailor it to your own firm and provide spaces for specific suggestions where applicable. For example, a question on fringe benefits was: "How do you rate the firm's policies on group medical, life insurance and similar benefits?" The choices for the answer were: "Excellent, good, fair, poor." There was no provision for staff members to indicate, specifically, how they would improve the program if they felt it was fair or poor.

Overall, the survey was encouraging, because to the question "If you were to start again, do you feel you would go to work with our firm?" no one answered "No."

Journal of Accountancy, *July 1970*

Appraisal of Staff Performance

Richard C. Rea

As soon as a practitioner has more than one person working at the same professional level, he will encounter the problem of evaluating or appraising the performance of each person. Perhaps this need for appraisal will first occur when salary increases are being considered; or it could be when a promotion is to be made. The need for a method of appraisal is not so acute when the staff is small, but as the number of people on the staff increases the problem of appraising and evaluating each member grows in proportion. Since nothing in our past experience or education has prepared us for this critical and important task, most of us will make the error of evaluating each staff member in relationship to the others.

In the January–February 1970 issue of the *Harvard Business Review,* Paul H. Thompson and Gene W. Dalton in an article entitled "Performance Appraisal: Managers Beware" describe the dangers of this method of evaluation, and conclude with some suggestions on how appraisals can be accomplished effectively and intelligently.

The authors tell us that performance appraisal touches on one of the most emotional activities in business life: the assessment of a person's ability and the value of his contribution to the organization. The signals he receives as a result of an attempt to assess him will have a strong impact on his self-esteem and subsequent performance. We should, therefore, carefully think through the consequences of the procedures which we will set in motion. Even though we start out on our program of evaluation and performance appraisal with the best of intentions, these good intentions are of little value if the results are disastrous. An incorrect approach to performance appraisal can have negative as well as positive emotional consequences. What do we hope to achieve?

First of all, we would like to have a system of evaluation which will motivate high performers to do even better, and those who are not high performers to improve.

We would also like to have a system which will identify those staff members with potential for advancement and reward them. Consistently low performers will not be rewarded and thus be encouraged to leave. Unfortunately most of us have had the opposite experience. Our best staff members are the first to leave and our low performers are the ones who stay.

We need a system which gives accurate and complete information to enable us to make decisions on salary increases, promotions, and other forms of recognition.

The system should be so designed that the staff members themselves know how they are viewed by us and what the future holds for them in the organization.

In the authors' opinion the principal trouble with most of us is in the use of the word "average." It is a good word in mathematics but has no place in dealing with human beings. There is no such thing as an "average" person. Each of us is an individual in his own right, and should not be judged in comparison with the performance of others. As soon as we try to place all of our staff in a bag, shake them up, evaluate them, and determine the "average," we are using what the authors refer to as the zero-sum principle. This means that if all staff members are assigned points above or below average, then the sum of the plus and minus points will always be zero. Grading by the curve is a zero-sum comparison. Hence if a new man is added to the staff who is rated below average, the zero point, or average, for the whole group drops. As a result it is possible that one staff member's rating, in relationship to the others, may then be increased even though his personal attributes and competencies have not changed.

If one person finds a way to increase his effectiveness it certainly doesn't follow that another person's effectiveness is decreased by the same amount. If anything, the reverse is likely to be true. The second person may very well learn from the first one and become more effective himself. In this sense there can be changes in which everybody wins.

There can be little satisfaction in being rated "average" in any group when the group itself may be one of the most competent and highest paid in the profession.

Fortunately peer comparison rating systems, with their emphasis on the "average" employee, are not the only available methods of assessing and providing feed-back on performance. The authors recommend that a person's performance be compared to objectives which he himself helped establish so that he and his superior are judging him against his own prior performance. In other words, the system must be future oriented. Rather than dwelling at length on the person's past, focus attention on his future.

We must remember that—

- Criticism often has a negative effect on achievement of goals.

- Praise can have little effect one way or the other.
- Most people will react defensively to criticism during the appraisal review.
- Defensiveness resulting from critical appraisal can produce inferior performance.
- The disruptive effect of repeated criticism on subsequent performance is greater among those individuals already low in self-esteem.

Of course the past must be examined for the clues it will provide for future improvement. But the focus should not be on where the person stands relative to his peers (which in most cases can be discouraging) but on what possibilities the future holds for him in the organization. It is the future rewards he anticipates that will motivate him rather than present rewards for past performance.

A good system must make it possible for all employees to experience positive changes when they are compared with their own objectives rather than with others. There is then a chance for almost everyone in the organization to feel a sense of accomplishment, growth, and progress; and each can feel that his contribution to the organization is increasing.

In a profession such as ours concrete measurable objectives are hard to express. But the effort and work it takes to set up a program of performance appraisal based on future objectives will seem a small price to pay in contrast to the emotional dangers of comparing a staff member with his peers. Our need for uniformity and consistency at the professional level should not be allowed to impose a rigid system on our methods of performance appraisal. This makes impractical demands on human organization.

Journal of Accountancy, *April, May 1968*

The Use of Money in Motivating Professional Personnel

Donald H. Cramer

In the accounting profession we may be prone to overvalue the ability of money to motivate others, for we talk in terms of money and dollar measures every day. We talk about goals in terms of money. We consider the brains and brawn of men as assets in which companies invest and from which they expect a good rate of return. And we speak of a compensation package and how we can motivate new employees to join our firms and how we can motivate, with money, veteran staff members to work harder.

We can correct any possible overemphasis by recognizing that effective motivation does not depend so much on the quantity of the motivator, such as money, as on the forms it takes in the motivational mix required to obtain maximum results for the amount of money invested.

Most management problems in public accounting seem to boil down to people problems, with motivation high on the list. One can identify and interview the best brains in audit, tax, and management services, but the basic problem remains in two forms: how to motivate a man to work for you and how to motivate him to do his best once he's been hired.

I would like to suggest that the most effective motivation takes place when a firm provides an individual with a motivational mix which meets the needs of his level of achievement.

Biologists tell us the desire and need to work evolved with man's physiological need to survive, protect himself, and realize his potential as a social being. Five sets of needs developed, and they can be arranged

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in order of importance, according to A. H. Maslow.[1] For convenience, these have been arranged as a pyramid by Charles D. McDermid.[2]

At the base are *physiological needs*. Once these needs are taken care of, a man may work for economical and emotional protection—that is, to satisfy *safety needs,* the second set of motivators.

After physiological and safety needs come three sets of needs which are seldom entirely satisfied. They tend to create a need for greater satisfaction. *Social needs* represent the first of these. Naturally, these needs find their most immediate satisfaction in the family and in groups. In a work environment, social needs typically find satisfaction in professional groups, discussions with colleagues at lunch, and in social functions such as annual conferences of various accounting societies.

Next comes the *need for esteem* including the desire for respect, status, and reputation for importance and power. These needs can be satisfied through club memberships, by an office in the executive section of a firm, by automobiles, by having a socially desirable address, or by any other accepted status symbol. Another form of this need has to do with pride in the importance of one's work and in volunteer activity for a political or social cause.

Finally, Mr. Maslow says, there is a drive or *need for self-realization.* This need concerns the fulfillment of one's highest potential. To an accountant this may mean becoming the managing partner of one's firm, or writing the definitive book on one's special field of accounting. This need, as you might imagine, is the hardest to fulfill. Others usually are more urgent and a man has only a short span of time in which to realize this full potential. This need is seldom fully satisfied at any one time and is therefore always an active motivator.

Variances in Motivational Mix

Now, of course, a person does not feel these motives one at a time in precise order. Neither is he able always to satisfy his needs just when and how he wants.

If something blocks the satisfaction of these needs frustration results. Frustration and fear of frustration can spur a worker to extra effort in order to reach a specific satisfaction. Long frustration, however, can eventually demotivate a person and even cause nervous disorders which interfere with his work.

An accounting firm which follows a strong "up or out" policy of raises and promotions can quickly frustrate the employee who fails to move up. Financial compensation tops the list of potential dissatisfiers.

1. Maslow, A. H., *Motivation and Personality* (New York: Harper & Row, 1954).

2. McDermid, Charles D., "How Money Motivates Men," *12 Keys to More Effective Management* (Bloomington: Indiana University).

A raise has less positive motivating power than it has power to frustrate when it is expected but not received.

There is a need to increase the challenge of a professional assignment as fast as a person can handle it. If such a challenge stimulates the individual at the level of his capability, his motivation will probably reach a peak of effectiveness. If the challenge exceeds his capability, he will not have the sense of "completion" needed for full stimulation and satisfaction. Frustration will likely develop. If the challenge is less than the man's capabilities, he will seek other professional stimulation, which can reduce his efficiency on his main assignment.

Arranging Assignments for Maximum Motivation

Since motivation depends so much on an individual's personal needs, money makes a poor substitute for understanding a man and the work he will do most effectively. If a partner carefully matches the professional skills of a staff person with appropriate challenges, he will generate a great deal of natural motivation. He may generate much less by relying on direct payment of money as the key motivator.

In matching people and work, the partner should, first of all, select those who will be stimulated by the variety of present and future demands of a professional engagement. Then the partner, after observing the employee at work and after a performance review, can arrange for the orderly development of the employee's skills to ensure the greatest possible sense of achievement. In a work situation, the professional wants "full utilization of his talent and training."[3] Provided economic rewards are fair, he wants challenge built into his job and, usually, relative "freedom from close and detailed supervision."[4]

Also, the partner, as much as possible, can schedule work assignments so that they give the employee the maximum amount of the kind of professional satisfaction desired. For example, if one excels in tax work, one ought to be given as much tax work as possible.

The partner, in addition, can praise, promote, suggest specialized training at the firm's expense, or give the staff member responsibility over the work of others. Other ways to support and extend the sense of satisfying needs are a raise in salary and encouragement to write articles, give lectures, and try for the bonuses awarded for outstanding achievement.

Although a raise and a bonus have been mentioned, many of the suggested motivations are not money but are indirect investments by a firm in a person's professional development and work satisfaction. This can

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3. Ewing, David W., and Fenn, Dan H., Jr., ed., *Incentives for Executives* (New York: McGraw-Hill Book Co., Inc., 1962), p. 12.

4. Ewing and Fenn, *Incentives for Executives,* p. 12.

even apply to such prosaic items as the carpet in the person's office, extra files, and paintings on the wall.

The higher one is on the professional ladder, the less power more money will have as a motivator. Most top-ranking professionals can be motivated best by challenges through which they can satisfy their social needs, their self-esteem, and their self-realization.

Businessmen and professionals generally consider salary as a measure of "the going value" of an employee; titles become hollow status symbols unless they rest on a firm foundation of salary. This is a point to remember before creating quantities of new partners who receive in salary what a manager would receive in another firm which has followed a more conservative policy for granting titles. Word gets around that the new partners are such "in title only."

As a profession, accounting provides opportunities for achievement, recognition, and increases in responsibility more quickly than industry. Thus accounting can attract top people from the universities in competition with industries which may pay higher initial salaries and have more generous fringe benefits.

Furthermore, experience with an accounting firm also opens the door to greater opportunities if a staff member later decides to move to a corporation or start his own firm. At least for a time, these "future money and satisfaction" factors will motivate the new employee.

Overtime offers an opportunity for younger staff members to make more money, but overtime work with most firms is more or less compulsory during some periods of the year. It is doubtful, under these circumstances, that specific payment for overtime work has any positive motivating effect on young people.

A reward for extra hours of work has become so commonplace in business life in the United States that it is expected.

The Bonus: How and When to Pay It

After a person has passed the salary level and classification for which overtime is required by custom or by law, a firm has three choices. It can (1) continue to pay overtime, (2) pay salary only, or (3) pay salary plus supplemental compensation. To make a wise choice, the partner had better first answer the question, "Which method is best for motivating my people?" As he searches for this answer, he should try to find the method that will best increase professional status, increase recognition of accomplishment, and increase the employee's sense of security.

I believe that the best method of motivating people is to combine salary with some form of bonus or supplemental compensation. When you pay supplemental compensation at the end of the busy season or at the end of the fiscal year, you may evaluate a person's performance during a logical and natural time period. You may consider the hours that he worked, the quality of his work, expansion of services to existing clients or new clients and, above all, his future value to the firm. Payment for overtime will not do this and salary increases merely reflect in *future* income the outstanding performance during a *previous* period. Salary increases and overtime payments, while direct money rewards, have less motivating power than the bonus. And in the professions it is usual for the bonus to increase steadily year by year.

Some thought should be given to the timing of a bonus. Will it have its strongest effect just before Christmas, right after the "busy season" or at the end of a firm's fiscal year? Also, will it have a better result if given in installments rather than once a year? Your experience may show what timing seems to motivate your people most strongly.

In addition to this regular bonus or supplemental compensation, you might consider, too, a special bonus or award for unusual performance. As an example, take this situation where a staff member, during a year, had to work more hours than normal for his office in order to complete some difficult assignments. A separate "one-shot" bonus check appropriately recognizes this extra effort. Such a check uses money directly to motivate a man.

Similarly, a special bonus may be given to your staff for attaining other goals—for example, a check for the best published article or for exceptional achievement in community affairs. Such rewards not only motivate recipients but encourage others toward similar accomplishments. Although the amount of the award cannot be too small, it does not, on the other hand, have to be large in relation to the man's total income. It motivates primarily by its recognition and reinforcement of self-esteem.

Meeting Competition for Personnel

For maximum power as a motivator, the bonus and salary structure combined should reflect the current market for professional talent. It should also have enough built-in flexibility so that it can top the average salary when necessary. For example, a firm with sufficiently flexible salary policies can recognize appropriately the staff member who is making unusual professional progress or who has had success in practice development. When a firm recognizes achievement in this manner it motivates the individual further and creates a stimulating and competitive atmosphere among its staff people.

The Problem of Sharing Profits

Let us examine for a few moments still another money motivator: profit-sharing. A carefully devised program of profit-sharing can stimulate key personnel to greater effort. The privilege of sharing profits may act as a motivator if granted to key people in charge of clients or departments or otherwise involved in the top management of your firm. That is, only those who have the major responsibility and authority for profits should receive the privilege of sharing in the profits. This will usually mean partners and managers.

Behind the Fringe

In addition to the fairly common direct uses of money, there are indirect uses which play their part in motivating the professional person. In public accounting perhaps the most significant of these relate to money spent for educational programs. Education may be one of the most effective means of motivating staff members. They value it as partial fulfillment of their need for self-realization.

Training programs generally motivate staff members positively in varying degrees. For maximum motivating effect, I suggest you single out staff members or young partners for participation in advanced management programs, American Management Association seminars, or other special conferences sponsored by business and professional organizations. Careful selection will tend to satisfy social and esteem needs as well as the urge for professional achievement.

Consider, too, the establishment of a policy to permit leaves of absence. To my knowledge this has not been done to any extent in public accounting but could be one of the best ways to provide professional and personal "self-renewal." Obviously, you would have to restrict the privilege of taking sabbaticals to partners or managers of considerable standing in your firm because the cost would be high. A sabbatical is not a long paid vacation but an opportunity to pursue a writing or teaching project, which will contribute to the professional growth of the individual.

The traditional fringe benefits also play their part in motivating people. Behind these benefits, of course, exists a money value either immediate or deferred (as a protection and guarantee of future satisfactions). These fringe benefits contribute to (1) safety needs, (2) social needs, and (3) esteem needs. CPA firms, on the whole, have been slow to recognize the motivation possibilities of these fringe benefits.

Group life insurance, hospital and major medical insurance, salary continuation plans, pension plans, and paid vacations all contribute to emotional protection. Memberships in professional organizations and clubs and reasonable expense allowances to participate in these professional and social organizations contribute to the social and esteem needs of the individual. A project carried out on a sabbatical can also satisfy, in part, I believe, the need for self-realization.

Money in a Motivating Mix

Fringe benefits add a further motivating dimension to the professional work environment. While plain cash has its limitations as a motivator, it is easy to oversimplify matters and undervalue these more sophisticated "fringe" forms of money. Remember, too, that various professional satisfactions such as work itself, achievement, responsibility, and praise are only one or two steps removed from the money which these satisfactions tacitly include or promise. Increases in fringe benefits, for example, frequently are triggered by a raise in salary.

Because of money's flexibility, it can be used directly to satisfy basic physiological and emotional needs, and it can be used indirectly as a symbolic measure for satisfaction of social, esteem and self-realization needs.

Once we recognize these motivating powers of money in relation to the five sets of human needs, we can maximize their economic use. We can make a motivational package or "mix" of the strongest money-motivators for any level of professional achievement. Ideally, one would fit this package to the individual as much as possible within the uniform policies of the firm. This may require some soul-searching and even a survey of the needs of each professional level—assistant, senior, manager, and partner.

Putting Money Where It Motivates the Most

When you hire an employee, explain the firm's compensation policies for various professional levels. Knowing what to expect as reward will motivate an employee to move up.

The larger accounting firm usually has a pamphlet explaining promotion policies and opportunities for advancement in the firm and the firm's money rewards. In smaller firms, the owner or managing partner may just sit down with new staff and talk about the growing responsibilities and rewards they can expect.

Though most of us probably explain the policy for advancement, I wonder whether we all put our money where we say we do. Yes, we work out a fair and uniform compensation structure. We base it on motivating personnel according to their needs at various professional levels. But then we must follow through on the policy of advancement and reward we have set. Otherwise any "extras" for outstanding performance have little meaning. Staff members must sense that the promotion and development program was designed and is being carried out fairly to reward and recognize their efforts and achievements.

As time goes on, performance review and performance appraisal sessions should be used for their full motivational potentials. They are opportunities for managers to identify a subordinate's needs, and to isolate frustrating barriers for possible removal. A raise or a promotion should also be an occasion to set new goals. This is a positive and effective way of using money to motivate professional people.

In summary, we come back to the hard fact that money's convenience as a measure of value and medium of exchange gives it the power to stimulate and therefore motivate professionals. It can do this directly in the form of salary, bonus, and profit-sharing, or indirectly in the form of fringe benefits and status-related rewards.

Used haphazardly or in a negative way as a penalty, money can cause dissatisfaction and frustration. In contrast, if money is used intelligently and positively in a motivational mix as a reward for work and as a symbol for broadening responsibilities, it enriches an employee's confidence and pride and becomes a strong motivator.

Journal of Accountancy, *November 1972*

How to Motivate Your Staff

Robert P. Levoy

Are your professional staff relations plagued by misunderstandings, disagreements, and friction? Has low staff morale and motivation led to lowered performance and higher turnover? Can these "people problems" be avoided in a typical accounting firm?

There are many ways to motivate your professional staff: you can pay them higher-than-average salaries, year-end bonuses, or perhaps set up a profit-sharing plan; offer special incentives for extra effort such as additional vacation time; use an authoritarian approach by threatening with "Improve performance or else!"; or develop the "people management" techniques that will make your professional staff want to do their very best.

At the outset, it's important to understand what motivates today's employee—that is, the factors that keep staff morale in high gear and contribute most to job satisfaction.

The U.S. Chamber of Commerce conducted dual surveys of management and employee attitudes on the subject of employee priorities in job satisfaction. Management's ranking of these priorities was (1) good pay, (2) job security, and (3) promotion and growth.

The employees' list, however, was quite different. Its first three priorities were (1) full appreciation of work performed, (2) feeling "in" on things, and (3) sympathetic help on personal problems. Job security was fourth on their list and good pay was fifth.

The fact is that in today's environment money and fringe benefits are not everything. Behavioral scientists are learning from studies of industry that today's employee places increasing importance on the psychological factors in a job, such as feelings of recognition, appreciation, and self-expression.

This change in values has arisen in part because of the generation gap of the 1970s. Today, young people are not as concerned about economic needs as their parents, who vividly remember the depression years of the 1930s. The "now generation" has grown up in comparative prosperity in an age of instant gratification.

In the accounting profession, today's typical college graduate is better educated and more broadly trained, with different perspectives and values. He has better salary and employment opportunities, more freedom to change firms or even relocate to a different part of the country if he so desires.

To deal effectively with these changes, management must concern itself with S.O.S.—staff-oriented supervision. It requires a sensitivity to a professional staff's needs and ambitions as individuals, and, if necessary, a willingness to change attitudes and approaches to people.

The insensitive manager or partner who is perhaps unintentionally aloof, cold, impersonal, and uninterested in his staff usually has his lack of interest reciprocated.

Put another way, the goal is not so much doing things to motivate people, but to keep from doing things which *de*motivate and demoralize the staff. The latest research has confirmed the long suspected fact that there are certain negative factors in a job situation which are so powerful that any one can cancel positive measures of stimulation and motivation.

Dos and Don'ts

Based on numerous practice surveys in a wide range of professions, here are some tested "dos and don'ts" to keep staff morale and motivation in high gear.

Do make yourself available for frank, unhurried discussions of staff problems and complaints. Remember what may seem minor to you can be very important to another person with a different background, experience, and perspective. Left unresolved, even a minor problem can be exaggerated out of proportion—taking its toll in lowered production and performance—through your neglect and indifference.

Don't attempt such discussions and solutions between engagements. The result may be that the problem will be left "hanging in air," worse than when it started, when you must leave to see the next client.

Do set aside a special conference time to discuss matters of policies, procedures, or personal problems with your staff—individually or collectively. Have your secretary hold all calls. Give your undivided and uninterrupted attention. Putting your staff's needs first is the key to proper people management.

Do plan agenda for these meetings in advance and give your staff notice of the subjects you would like to discuss. Give them time to organize their thoughts and suggestions. The results will be more productive than spontaneous thinking.

Don't belittle or criticize a staff member in front of others and never in front of clients. This may sound trite, but it happens. During an engagement, a staff accountant makes a verbal slip with a client. The temptation is to butt in and blurt out, "For God's sake, John, etc." John is mortified in front of the client. He will never forget the humiliation. Nor will he forgive you for it.

A put-down at a staff meeting can be equally disastrous and morale-destroying. Even worse, it will stifle future ideas and suggestions. In the long run, you'll lose.

Do consider the timing for your reprimands. An evening criticism, for example, can be exaggerated by darkness or end-of-day-fatigue. A Friday reprimand destroys the weekend.

Don't play favorites. This is another rule of good people management. When you start to make exceptions because of personal preferences, especially when the person you favor is playing up to you, the rest of the staff adopts a "what the hell" attitude.

Don't "show up" a staff member. It's embarrassing to a staff accountant to have his supervisor or manager show off at his expense; for example, by doing a particular job better or faster than he can do it himself. Of course, most managers can because of their experience. But it's important to a person's dignity to be able to do something well on his own. When you take his work away you also take away his self-respect. You are, in short, demotivating him.

Do be sensitive to little things. A written note of thanks for a job well done may seem insignificant alongside your other responsibilities, but to a staff member it says, "I care."

A staff accountant to whom I was speaking at a seminar I conducted for the Alabama Society of CPAs was discussing a recent job offer he had received. He was offered more money and responsibility than his present position. His final decision, after talking it through, was: "I can't leave my present firm; the partner in charge is tough and demanding, but he is considerate in ways I will never forget. When my wife and I recently vacationed in Bermuda, we found, on our arrival at the hotel, a tremendous bouquet of flowers in the room from the partner and his wife. He had remembered that this is where we had honeymooned."

Countless incidents that I have heard such as this only reinforce my conviction in the human relations value of little things—not as a *substitute* for salary and fringe benefits, but as an important *supplement* to them.

In our surveys, I have found that low staff morale is caused not by a lack of concern on management's part, but rather by a failure of management to communicate its concern to the staff. Remember, it's not how concerned you are about your staff that keeps morale and motivation in high gear; it's how concerned your staff thinks you are.

Do give praise when appropriate, but avoid praising every little thing your staff does for the praise will quickly lose meaning and may even demotivate your people. Praise is like seasoning—a little bit is better than a lot.

Praise a staff member for what he *does,* not for what he *is* (i.e., praise the efficiency, thoroughness, or promptness of a job well done—not the person). When you praise the act, your praise is specific and sounds sincere. Praising the act also creates an incentive to do more of the same. Praise a staff member for his diplomacy, thoughtfulness, and diligence with clients and he'll try even harder in the future. Also praise in the presence of others, if possible. It has a multiplier effect.

Do listen to your staff's ideas and views. Your personnel may well be better attuned to your clients' likes, needs, and interests than you because of a difference in age and background. The more thinking you can get on client relations, practice growth, policies, procedures, and any other facets of practice management that are appropriate, the better. Just asking for your staff's opinion will be appreciated. Most importantly, you will be encouraging "participative management," one of the keys to S.O.S.

Do verbalize your firm's management philosophy with your staff. No one wants to work without an objective. Make your people aware of management's goals, its priorities regarding tax, audit, management advisory, and estate planning services, time utilization, client relations, new client development, participation in civic and professional activities, and interprofessional relations with allied fields.

Such discussions are evidence of management's willingness to inform the staff of matters in which they have a direct interest; it's another way of showing concern. Moreover, the "give and take" communications described above have proven to be of tremendous motivational value.

Do have a written manual of the firm's policies including specific information about salary reviews, promotion and advancement, performance standards, chargeable hours, holidays, vacations, sick leave, continuing education, fringe benefits, grounds for dismissal, and severance pay. Go the full route including outside activities, expense accounts, and anything else relating to general policy. The fewer communication gaps you have with your staff, the fewer will be the communication breakdowns and misunderstandings.

Don't be a poker face all the time. Don't be afraid to laugh, indulge in humor, or just plain have a little fun in your work. Be people-oriented as well as accounting-oriented. You'll find that the human touch can often be the Midas touch in solving people problems.

Do periodically review staff performance to let your people know where they stand and, more importantly, to help them grow. Studies in industry have shown that such evaluations can become a springboard for improvement in both motivation and performance, while at the same time reinforcing staff feelings of participation and recognition. Among the subjects that may be profitably discussed are—

- Which goals for the preceding year were most satisfactorily achieved?
- What were the reasons for this satisfactory performance?
- Which goals were less satisfactorily achieved?
- What were the reasons?
- What are the implications for the future?
- What alternatives or action-steps should be considered with a view toward increasing potential and performance?

In its most effective form, a performance review should incorporate all the elements of staff-oriented supervision.

Don't resist change just because things have always been done in a certain way. Don't have hard and fast regulations, policies, or procedures that never sway even under the most extreme pressures. Stay loose. Be sensitive to the possibility of change, especially when the ideas or pressures are of staff origin.

Winston Churchill believed it was not a sign of weakness to modify an opinion or position. "There is nothing wrong in change," he said, "if it is in the right direction. To improve is to change, so to be perfect is to have changed often."

I hope the common thread throughout this article has been the idea of giving the staff something extra above and beyond a good salary, fringe benefits, and pleasant working conditions. In just three words, these extras can be summarized as "giving of yourself" in little, personal ways that will keep professional staff morale and motivation in high gear—a principle for that matter which can be applied with equal effectiveness to nonprofessional and clerical staff.

Journal of Accountancy, *September 1977*

How Not to Motivate Your Staff

C. David Stauffer

With no previous experience in the area of firm administration, we thought it would be a good idea to talk with other small local firms and perhaps we would be able to develop sound policies based upon their advice and experience.

We were somewhat surprised to discover that many of them, intent on maximizing their own income, adopted a philosophy toward staff management which went something like this: "It is truly difficult for a small practitioner to earn a decent living in today's business environment. It was a much more respectful environment in which I got my training and later successfully started my own CPA practice. These days the staff people want bigger salaries, their own offices, brighter lights, insurance plans, and are constantly asking all sorts of personal questions about how the practice is managed. I have discovered that it is possible to keep your own income relatively high, and yet not give in completely to their demands."

I'm sure practitioners can benefit from knowing the wrong way to treat employees and clients:

1. Show them that there are more important things in life than money. You may not pay them well, but you won't fire them either. They have a job with you as long as they understand their position.
2. Impress upon them the esteem and importance of being a partner. This is important and can be done in several ways:
   a. Make appointments with clients and then don't show up or be at least a half hour late. This shows that you are more important than they are.
   b. Tell staff members that someday they, too, can be partners. Be careful with this one. Be sure not to get too specific or you may actually have to go through with it.

   c. Be sure *your* office is large and has a comfortable working area. This will make them work harder so they, too, can have an office someday.
   d. Don't let them assist in any aspect of the management of the firm. They'll just expect more and better responsibilities.
3. Don't let them have any idea of how much you really make in a year. It helps to drive older cars or let a few threads show on your suits. They are then much more understanding of why their annual raise was $20 per month instead of $80.
4. Let them know they are expendable. There are plenty of job applicants available and it always helps to get that extra effort from a person who knows he may lose his good job if he doesn't produce.
5. Do not send them to any seminars or other training sessions. We all know how expensive these can be. But the worst part is that they never stay around long enough to really let you benefit from the experience. It's therefore best not to invest too much in them. Besides, if you have been too busy to keep current yourself, it's dangerous to have them know more than you do.

Those practitioners who have operated under these tenets can tell you that their income and gross billings have been at about the same level for several years and have seldom increased. But they probably feel it's better that way because they can't attract sufficient staff to take care of the additional work anyway.

Needless to say, we decided that we would make every effort to keep our firm free of such attitudes.

How do your staff people view their functions in your firm? Are they adequately challenged with the responsibilities they have? Are you really trying to prepare them to be future partners? Every effort at communications among all personnel in the firm will certainly improve your own staff motivation. As a start, we challenge you to ask your staff people what their reactions are to this article.

Journal of Accountancy, *November 1970*

The Importance of Delegating

A. S. Kennedy

How often do we hear it said? "If you want a job well done, you have to do it yourself." This attitude does not recognize the importance of delegating.

What Does Delegation Mean?

Delegation has been defined as the willingness of someone at a higher level in an organization to accept and support the decisions made and actions taken by others at a lower level.

Who Needs to Delegate?

Ask yourself these questions:

1. Is your work behind schedule?
2. Do your assistants appear to lack interest in their work?
3. Do you have difficulty in finding time to talk to people?
4. Do you often feel irritable, worried, or tired as a result of work pressures?
5. Do you spend too much time on minor detail work?

An affirmative answer to two or more of the above questions indicates that you are not delegating sufficiently. It also means, of course, that you are not working as efficiently as you could be.

The benefits to be gained from delegation far outweigh any benefit that may arise from the superior performance of a lesser task.

How Does One Delegate?

Set out below are five steps to successful delegation.

Selection. Analyze the work you are doing at present to see if some of it could be passed on to an assistant. Remember that you have an obligation to give adequate attention to your more important tasks. The question is not whether the assistant can do the job as well as you, but whether he can do it adequately.

Allocation. Analyze the capabilities of your assistants and, where practicable, delegate jobs that will bring out the best in them.

Instruction. It is an important prerequisite that the overall policies and procedures of the firm be understood by the assistant.

What instructions should be given?

Specify the goals and objectives—what has to be done and why, how well, when, and in what priority.

The following points should be covered:

1. An outline of the job.
2. How it has been done in the past.
3. How it fits into the total job (if appropriate).
4. How much detail is required and what level of accuracy is required.
5. How long the job should take, step by step. (Be realistic in this assessment and make due allowance for newness at the job.)
6. Stages at which progress on the job will be monitored.

An experienced employee may be adequately instructed by a brief description of the job, but a junior employee may require instructions in full detail.

Authority. It is essential that authority be delegated along with responsibility. The assistant must assume responsibility for the complete job.

After delegating a job, don't become re-involved unless there is a serious situation which the assistant cannot correct.

Don't ask for information which the assistant should be asking for himself.

Don't do part of the job yourself.

Don't make decisions the assistant should be making. If he asks for a decision on a particular point, turn it back to him and say "What do *you* think should be done?"

Remember, the assistant should be given freedom of action and freedom from interference.

Control. Authority and responsibility are delegated to the assistant but the ultimate authority is never delegated.

Delegation without controls would amount to abdication or the surrendering of rights and responsibilities.

The form and number of controls would depend on the experience of the assistant and the complexity of the job.

The most commonly used controls are as follows:

1. The area of an assignment delegated should be clearly defined and limited to the ability of the assistant.
2. Brief progress reports should be requested at defined intervals.
3. The results from the progress reports should be assessed and errors corrected. The correction of errors frequently requires tact.
4. Rewarding of work well done if this is justified.

One last word of advice. Whatever you do—"Don't spend dollar time on penny jobs!"

Journal of Accountancy, *July 1974*

Delegating Authority: An Outline of a Talk

Marvin L. Stone

My comments are based on personal observation.

1. Not supported by scientific research.
2. Hence, subject to my own bias and limitations.
3. Also, subject to danger that my conclusions are wrong, even though drawn from actual experience.

Usual connotation of delegation is that it's desirable.

1. Not absolutely so for everyone.
2. Requires commitment to growth.
3. Even a sole practitioner without professional staff must delegate some tasks in the interests of efficiency.

Delegation presupposes two or more people.

1. My remarks are addressed to the practitioner with one or more associates who aspires to improve his or her lot.
2. I'll speak of subordinates; also mean lateral and even upward delegation.
3. I've bared my first obvious bias—i.e., I think delegation is desirable.

Delegation is only one of a close-knit trio of attributes found in a good administrator or executive.

1. Organize, deputize (delegate), supervise.
2. Like love and marriage—can't have one without the other.

Before delegation, CPA must organize.

1. Take stock of what must be done and who is available to do it.

2. Match one with the other.
3. Indiscriminate delegation without planning is likely to do more harm than good.

After delegating, the CPA must supervise.

1. That's the difference between delegating and just "copping out."
2. Delegation without supervision can be ineffective and extremely dangerous.

Traits of good delegators.

1. Secure, well-adjusted (feels needed and wanted).
2. Dedicated to firm vs. individual concept.
3. Willing to risk subordinate's doing poor job.
4. Also willing to risk subordinate's doing good job.
5. Self-knowledge.

Since delegate means "entrust to another," successful delegation requires confidence in associates.

1. Recruit accordingly.
2. Successful recruiting itself requires self-confidence; otherwise one tends to hire inferior people who pose no threat.

Successful delegator must defend, not deride, subordinates.

1. Good leader accepts more than his or her share of the blame and also takes less than his or her share of the credit.
2. Builds rapport with subordinates.
3. More important, also nurtures confidence of clients and other outsiders (even staff members) in subordinates.
   a. Not likely to think more of them than you do.
   b. Confidence is delicate blossom.

Communicate delegated tasks clearly.

1. First to subordinate.
2. Then to others who should know.
3. If your efforts at delegation too often result in disappointment and failure, poor communication *may* be cause.

Curb natural inclination to do everything yourself by proxy. Don't stifle innovation by excessively detailed instructions.

1. Stress objectives rather than methods.
2. Inform subordinates of such constraints as time and cost limitations.

What tasks to delegate?

1. Those you dislike? Not necessarily.
2. Those that clients will permit.
3. Those which fit talents of associate and will help him or her grow.
4. Those which you've short-changed because of disinterest, etc. (but be sure your lack of enthusiasm isn't communicated).
5. Those which don't merit high-level attention.
6. Things others will do better.
7. Tasks which logically belong together.

Client responsibility hard to delegate after you've established relationship; switch early.

Provide conducive environment for further delegation.

1. Subordinates must not feel you'll think them lazy.
2. Subordinates should not be made to feel others are competitors or threats.

Responsibility must accompany delegated authority.

1. Opposite situation more often the problem.
2. Real, not imagined, tasks must be delegated; in my office the title "Chief of East Asian Operations" wouldn't mean much.

Results of well-thought-out plan of delegation.

1. Better, happier personnel; "properly done" is a compliment.
2. More efficient use of time—yours and others' ("efficient"—highest quality at least cost).
3. Not necessarily fun, particularly for good technician who would rather do than manage.

Supervision is final essential element.

1. System of feedback and follow-up essential.
2. Criticism should always be constructive and private.
3. Don't forget to compliment meritorious work; most of us only remember to criticize failures.
4. Stay in close enough touch to permit corrective action if delegate is not performing properly.

Delegation is the only road to growth; however, delegation—and growth—are not for everyone.

Journal of Accountancy, *June 1971*

Constructing a Staff Manual

Lee Engel

Every accounting firm has its policies, rules, and procedures; as the firm grows, more are added. In most cases they are developed by necessity, sustained by tradition, and conveyed by memo or word of mouth. They are committed to memory because nobody has the time to commit them to a permanent record. A memo issued in 1966 on how and when to obtain a liability certificate will be filed under Miscellaneous, will be hard to retrieve and, it is hoped, will be enforced by partners and reviewers with good powers of retention.

While few will dispute the advantages of having a manual in the CPA's office, it may be well to enumerate some of them.

A manual fixes responsibilities, answers questions, shortens training time of staff and employees, minimizes disputes, promotes uniformity, makes routine decisions, and overcomes difficulties of transition when two firms merge.

Since writing a manual requires a prohibitive amount of time, and thus cost, the following is intended to show how to construct the nucleus of a manual (NOM) and complete the sections on an "as we go" basis.

The NOM becomes the receptacle of staff letters, policy pronouncements, memos that have more than one-time validity. An instruction on how many copies of a conference memo will be prepared—with distribution list—should be incorporated in the NOM; the announcement of the date and place of this year's Christmas party should not.

If we envisage the finished product, we shall see two large divisions of the manual: Administrative and Professional. Since there are many subdivisions under these divisions that come immediately to mind—e.g., auditing, taxes, management services, writeup under Professional—we need a numerical structure that is logical, flexible, and easy to build. The Dewey decimal numbering system appears to be the best available.

The Dewey decimal system, named after a famous librarian, has been adopted in city and college libraries. It gives a basic number to, say, fiction, religion, history, geography and a subnumber to the right of the decimal point to subsections. Thus, if Administrative is 1 in our NOM and Personnel Policy is the first subsection of Administrative, it would be numbered 1.1. Subsections of personnel policy could be job descriptions called 1.11 and hiring and discharging 1.12. If we want to create sub subsections for job descriptions of secretaries, statistical typists, and receptionists, we number them 1.111, 1.112, 1.113, respectively. In this manner, each portion of a number becomes meaningful and logical. The 1 left of the decimal point means Administrative, 1.1 means personnel policy, 1.11 means job description, 1.111 means secretaries. On each level we have 9 possible sections or subsections (the zero belongs to the next higher section because 1.1 and 1.10 is the same).

Suppose we want to describe the job of an executive or partner's secretary which logically belongs to 1.111 and cannot be placed under 1.112 which is already reserved for statistical typists. Mr. Dewey has the easy answer: executive secretaries go under 1.1111. If, to stretch the point, we need the description of a statistical typist (1.112) who also binds tax returns we number that description 1.1121. Using the decimal point we are able to insert to our heart's content: between 1.423 and 1.424 we insert 1.4231, 1.4232 and so on without any limitation.

For the construction of our NOM we buy a good-looking medium-sized three-ring binder, start with an index page listing every item that should go into the manual in logical sequence with its Dewey decimal number, and set up dividers for the main sections. After each divider the index of the section follows. As we have mentioned, the main sections are 1. Administrative and 2. Professional. Administrative concerns the people, files, forms, and books in our office that support our work.

The main sections of Administrative could be—

1.1 Personnel policies.
1.2 Files.
1.3 Forms.
1.4 Internal bookkeeping.
1.5 Libraries.
1.6 Office equipment.
1.7 Secretaries, typists, receptionists, etc. (duties).
1.8 Written communications.

The main sections of Professional could be—

2.1 Personnel policies.
2.2 Auditing.
2.3 Taxes.
2.4 Management Services.
2.5 External bookkeeping (write-up).

For whatever guidance it may give I am listing most of the sections and the subsections used in the files section of the NOM of our Los Angeles office. As soon as we have established our sections, we can flesh out the skeleton of our manual with memos and instructions fished out from the files or issued currently as long as we number them properly, list the number in the index, and file them correctly under the appropriate section number. A procedure on files must go under 1.2, one on vacation policy under 1.1, one on the return of books to the office library under 1.5. The exact number is determined by logical analysis; it should not be left to the file clerk.

Having command of the techniques described will have an additional advantage: we shall be able to help our clients to streamline, clarify, and formalize their procedures. Thus, we shall improve the management of our own office, the service to our clients, and make some money in the process.

Policies and Procedures Index

1.	ADMINISTRATIVE
1.01	Chart of Organization
1.1	*Personnel Policies*
1.2	*Files*
1.201	Requisitioning, Issuing, Refiling
1.2011	Requisitioning by Partner or Staff
1.2012	Issue of Files
1.2013	Return of Issued Files
1.2014	Night Procedure
1.21	Audit Files
1.211	Work Paper
1.2111	Noncurrent Work Papers in the Office
1.2112	Noncurrent Work Papers in Storage
1.212	Permanent File
1.213	General File
1.214	Confirmation File
1.215	Inventory File
1.216	Tax Examination File
1.217	SEC File
1.218	Management Services File
1.22	Tax Files
1.221	Tax Envelopes
1.2211	Current Information
1.2212	Last Year's Tax Return
1.222	Tax Files Noncurrent in the Office
1.223	Tax Files Noncurrent in Storage
1.23	Clients' Correspondence File
1.231	Audit
1.232	Tax
1.2321	IRS Examinations
1.233	Management Services

1.24	Other Correspondence
1.241	Firm
1.2411	Intraoffice Los Angeles
1.2412	Interoffice—Los Angeles to and from Other Offices
1.2413	Staff Training
1.24131	Los Angeles
1.24132	National Office
1.24133	Other Offices
1.243	Prospects
1.244	Firm Letters to Staff and Clients
1.25	Reports
1.251	Audit
1.252	SEC
1.253	Nonaudit
1.254	Management Services
1.255	Nonclients' Published Reports
1.26	Record Retention
1.261	Move from Current to Prior Years at the Office
1.262	Move from Prior Years at the Office to Storage
1.263	Move from Storage to Destruction
1.27	Duplicating, Multilith, Photocopying
1.271	Requisition Slip
1.272	Responsibility
1.273	Delivery
1.274	Night Procedure
1.28	Supplies
1.281	Storage Locations
1.282	Ordering Procedure
1.2821	Purchased Supplies
1.2822	Reproduced
1.283	Issue
1.2831	Los Angeles
1.2832	Other Offices
1.3	*Forms*
1.4	*Internal Bookkeeping*
1.5	*Libraries*
1.6	*Office Equipment*
1.7	*Secretarial, Statistical, etc.*
1.8	*Written Communications*
2.	PROFESSIONAL
2.1	*Personnel Policies*
2.2	*Auditing*
2.3	*Taxes*
2.4	*Management Services*
2.5	*External Bookkeeping*

Audit Conferences

Michael H. Granof

Although CPA firms expend substantial sums in sending employees to professional development programs, they often overlook opportunities for staff development on a day-to-day basis. Specifically, conferences of personnel assigned to an engagement, both before and after the audit, offer an effective means of providing staff accountants with insight into auditing that might not otherwise be obtained until these accountants were several levels beyond their present positions. These meetings also offer a means of increasing staff efficiency and morale and firm profitability. They can benefit both small and large firms.

Description of Conferences

A pre-audit or audit planning meeting is conducted shortly before the firm begins its interim field work. This meeting is directed primarily toward the forthcoming audit, but topics pertaining to the entire engagement can also be discussed. Among the specific topics that may be considered are—

- Industry trends.
- Personality characteristics of key client employees.
- Critical problem areas of financial reporting (e.g., means of accounting for unusual transactions, impact of recent AICPA or Financial Accounting Standards Board pronouncements, methods of recognizing revenue on new corporate ventures).
- Special audit problems (e.g., difficulties likely to be encountered in observing and valuing inventory or in confirming accounts receivable).
- Unusual tax problems.
- Administrative problems about which the client would welcome recommendations from the firm.

The typical meeting would generally last anywhere from 30 minutes to several hours.

A post-audit meeting is similar to a pre-audit meeting. It is held after the completion of the client audit and is attended by the same group that was present at the pre-audit meeting. Its primary objective is to provide the staff the opportunity to appraise its own performance and to identify areas in which changes should be made in the next client audit. The staff evaluates the proportion of time spent on each phase of the audit and examines the variances between budgeted and actual hours. It attempts to specify areas in which the firm could improve, or provide additional service to the client, and considers recommendations that should properly be included in an internal control, or similar advisory letter to client management. The staff discusses means of improving the audit program and increasing efficiency of the audit in the following year. The final step is the preparation of a revised budget and tentative audit program.

Advantages

There are numerous benefits to be derived from audit conferences. First, such conferences improve coordination among personnel assigned to the engagement. Each person is more fully aware of what colleagues are doing, and, as a result, there is less likely to be duplication of effort—duplication which often occurs despite the most carefully prepared audit program. Each auditor is cognizant of the responsibility with which he has been entrusted and realizes that if he doesn't properly perform the task assigned to him, it may not get done. Equally important, members of the audit staff are concerned with the problems that might be the primary responsibility of others on the job and can make it a point to acquire information that they may later need. If, for example, gains or losses on depreciable equipment tend to be a recurring tax problem, the auditors can give extra attention to the fixed assets phase of their examination.

Second, juniors on the engagement are given the opportunity to view the examination from the top rather than the bottom. They see how their work fits into the total audit, and, by having a look at the total picture, they are less likely to follow the audit program perfunctorily or routinely prepare work papers identical in format to those of the previous year. The audit planning conference is likely to make the junior aware of the critical issues presented by a particular job and to instill in him a sense of audit proportion that is difficult to develop in formal training programs. He might not otherwise obtain this training until much later in his career.

Third, the audit planning and evaluation conferences give the personnel assigned to the job, particularly the younger staff, an increased sense of self-esteem and job satisfaction. Staff accountants may participate in numerous jobs, but they may get emotionally or intellectually involved in very few. Audit conferences will help to assure the staff auditor that he plays a significant and integral role in the engagement and may therefore be a major force in reducing employee turnover.

Obstacles

The major obstacle in implementing a policy of required pre- or post-audit meetings—and the primary reason for the resistance of many firms to such a policy—is problems of scheduling. Although the meetings themselves may last less than an hour, several additional hours may be required for travel to and from the office. More important, since there is seldom any slack in job schedules, it is often difficult for an auditor to "break away" from another assignment to return to the office for a conference.

To minimize the burden, meetings can be held on evenings or Saturdays and, when feasible, more than one engagement can be discussed at the same session.

The audit conference represents an additional cost of performing the audit, and such cost will not necessarily be recoverable through increased audit fees. The real question facing the CPA firm, therefore, is whether the benefits, most of which are either long-run or not highly visible, are worth the costs. The costs can be measured directly and immediately in terms of lost time. The benefits, on the other hand, take the form of increased audit efficiency, improved client services, higher staff morale, more competent personnel, and reduced turnover.

Journal of Accountancy, February 1977

The Human Element in an Audit

Charles B. Larson

The basis for fee determination by most CPA firms is time. Various systems have been adopted by firms to accumulate their time charges: time sheets, one-rite systems, and data processing. Audit files usually have time summaries built into the file to analyze time charges by audit functions which are then compared with engagement planning. Time estimates then provide a means of deadline control and later of variance analysis.

Scheduling systems usually are quite adequate and most engagements get off to a good start. But in the middle of the job, in spite of the time system and job controls, things sometimes begin to slip. Deadlines are not met and overruns that can't be billed will occur.

The key element in the problem does not show up on any form or report. That key element is the attitude of the staff person on the job.

Recently the audit manager for our firm identified this human element of the deadline problem and developed a staff meeting program which he presented, pinpointing the whys and wherefores of deadline control. An outline of this staff meeting program follows.

Deadlines

Types of Deadlines

Real—set by (*a*) financing agreement, (*b*) bond indenture, (*c*) the SEC, (*d*) new borrowing to meet cash flow projections, (*e*) other.

Client imposed—(*a*) tired of having us underfoot, (*b*) arbitrary, (*c*) wants to know results, (*d*) creditors are getting nervous. Once set, these deadlines are and should be considered real. In the final analysis, if the client is put on a deadline, it's your real deadline.

Firm imposed—(*a*) to impress clients, (*b*) to soothe a ruffled client, (*c*) to make a review and processing of several jobs flow smoothly, (*d*) to fit the schedule, (*e*) to leave a margin for new work and for unavoidable misses.

Reasons for Setting and Meeting Deadlines

The reasons for real deadlines and for client imposed deadlines are self-explanatory. The reasons for firm imposed deadlines may be a little less obvious. Believe it or not, these deadlines are not always dreamed up just to cause ulcers, migraines, and domestic problems. (Those are only by-products.)

Billings and Collections

Probably the most important reason for making and meeting deadlines is billings and collections.

1. A job which breaks a deadline and drags out is almost always a disaster. Since disasters are unprofitable, try to meet the deadline, and if it can't be done, try doubly hard to keep the time at a minimum.
2. It is easier to collect a reasonable fee and to raise the fee of a happy, impressed client.
3. It is easier to hurry collection of a bill from a happy, impressed client.
4. Unfortunately, many jobs are billed on completion and 3 or 4 days past a deadline can mean a 30-day lag in billing and consequently in collecting.
5. If jobs are delivered but not wrapped up, we either get the 30-day (or even 60-day) lag or we miss some billable time.

Office Administration

1. Staffing is based on scheduled requirements.
   a. We don't want to overstaff.
   b. We don't want to understaff.
2. Overtime requirements are affected by scheduling. When we get behind, overtime may result until we are caught up.
3. Unhappy clients pay lower fees, which leads to lower compensation.
4. Input to scheduling must be accurate and timely to avoid monumental errors in scheduling.
5. Progress reports must be timely.

6. We expect our pay checks on time. Shouldn't partners expect our audits on time?
7. Tax departments meet deadlines so why can't we?
8. Good scheduling allows interdepartmental and interoffice staffing, which cuts down on overtime and/or additional people.

Review

1. When jobs are properly planned and deadlines met, they will come in for review and typing well ahead of delivery date. The reviewers and typists can't handle four jobs in one day.
2. Often when an audit lands on a reviewer's desk late it could well be second, third, or fourth in line. He's on a schedule, too.

Scheduling

1. The schedule is and must be flexible, but with a little effort on your part, it needn't be a complete disaster.
   a. Plan some overtime as soon as a job lags.
   b. When a client isn't ready, be prepared for alternative action—work on another client so your time isn't lost.
2. A delay by some other client may free up a person to help you meet your deadline or your delay problem may free staff to help others. Ask.
3. Religiously prepare progress reports, then read them—do they show a problem developing? How can it be solved?
   a. Ask for help on a timely basis. Work overtime.
4. Start on progress reports early Friday afternoon. They are for your benefit as well as for management's.
5. Stay on top of or ahead of your job. Look down the road days or even weeks.

Problems and How to Overcome Them

Communications

1. You shouldn't be expected to meet a deadline you don't know exists, but you will be expected to, so ask the scheduler, the partner, or in some cases, the client. Maybe he has a deadline you don't know about.
2. Review the situation to see if it's realistic now and continuously, not after you miss the deadline.
3. If a deadline is impossible as scheduled, discuss with partner, scheduler, or client as appropriate—now.
4. A client must know what is expected of him as soon as possible.

5. Thirty minutes spent on an assigned job 30 days ahead can easily save two days later through improved planning and obtaining commitments from clients.

Client

1. Client personnel usually don't feel any pressure to be ready for you, so if the client imposes a deadline, you must be sure his staff knows the timetable to be followed, including delivery date for receivable trial balances, confirmation typing, extended inventory, depreciation schedules, etc.
2. The client must be the one to pressure his people, not you.
3. Many times, a word to the right person when the client's staff starts slipping behind will solve the problem.
4. On your staff imposed deadline, you are somewhat out of luck if the client isn't ready when you hoped so be realistic in your original projections. Don't say the books will be ready by the tenth if it's been the twenty-fifth for 10 years in a row.

Staff

Problems include illness, slowness, or lack of planning and forethought.

1. Set up your own timetable for the job. Coordinate with the official timetable.
2. Try to stick to it.
3. If it starts slipping, can it be kept on schedule with a little, or a little more, overtime?
4. If not, inform the manager; maybe help can be provided. (The sooner you request it, the better.)
5. If you can't get help, maybe deadlines can slip, or maybe you should plan on more overtime.
6. Have a solution, or several, worked out in advance; don't expect someone to solve it all for you.
7. Keep in close contact with assistants' progress. Don't be surprised two days before the deadline.
8. Learn to be a mother hen. Anticipate problems; then be ready with solutions.
9. If your job blows up, you put a catch-up burden on the rest of the staff.

Self-discipline

1. Most previous comments apply.
2. If you don't want people telling you how to do a better job, then do a better job before they tell you.

3. What do you do to improve your professional abilities? You do a lot to improve your softball team.
4. Are you willing to plan a job as carefully as you would your vacation?

Summary

You are a professional person. Assume the responsibility for doing a professional job—within time and on time.

4

Partners and Partnerships

Journal of Accountancy, *August 1975*

On Being a Partner

William R. Gregory

The ideal and successful partnership is one that is based on mutual trust and respect and the coordination and best utilization of the partners' talents. Although we are all professionally qualified, the very diversity of backgrounds, talents, personalities, and the services to be rendered call for different roles for different partners.

Therefore, in the evaluation of partnership performance, the criteria to be considered need not necessarily be met in their entirety. It is important, rather, that the individual be evaluated in terms of the strengths and talents that he contributes to the firm as a whole. Those criteria that may be considered follow.

Character

Having achieved the professional designation of CPA is of itself an indication of some character. To be a partner requires more. Partners should possess those traits of integrity, loyalty, sincerity, humility, patience, and mutual respect necessary to provide a fruitful and harmonious business relationship, in which the long range good of the partnership may sometimes transcend the immediate good of the individual.

Technical Ability

A partner should demonstrate superior technical ability and professional dedication. This may be shown by superior services to clients, by leadership in continuing education and professional development, and/or professional recognition of an attained expertise. Such superior technical ability may also be evidenced by on-the-job training and development of staff, and by development and maintenance of the firm's technical manuals.

Personality

Although it is recognized that each partner has a different personality, certain characteristics are essential for an effective partnership. A partner must be able to work in harmony with others—the partners, staff, clients, and the business community. He should possess that combination of characteristics that makes him attractive to most people; being a professional, he must have gained by his conduct and demeanor the respect of a professional.

Leadership

A partner must demonstrate and provide leadership. Leadership can be demonstrated in many ways: accepting responsibilities and taking the lead in various technical areas in which the firm is involved; participating and being interested in the various management responsibilities of the firm; setting the example for the staff in such areas as work performance, office conduct, hours, loyalty, enthusiasm, and dedication to the firm and its objectives; showing interest in the progress and development of individual members of the staff; and willingness to work above and beyond the standard.

Business Developmental Ability

A partner should be able to generate additional client engagements. A firm cannot survive, much less prosper, without new business. Therefore, a basic partner responsibility has to be the recognition of this fact and the willingness to commit time and energy toward that end. It is also recognized that each partner will accomplish this in his own way, whether it be by providing superior client service, outside community and/or professional activities, personal contacts, or a combination of these.

Outside Community and Professional Involvement

It is not enough for the CPA who wishes to be successful to function solely within the confines of his professional practice. Therefore, a partner shoulders a responsibility to devote time and energy to activities outside his firm, recognizing that this, in turn, requires a degree of sacrifice from his personal time. It is rare, however, that participation and contribution of effort toward an outside interest do not result in a high degree of satisfaction and reward, both personally and for the firm. Being active within the profession is an easy and natural route to follow, as is participation and involvement in civic, charitable, and social organizations. CPAs have a unique blend of training and experience to offer a community; a partner's responsibility includes a commitment to put those talents to work.

Relations Between Partners

Carl M. Chilton, Jr.

One of the areas of practice management that seems to have been neglected in our literature concerns the maintenance of good communications and stable relations between partners.

It is difficult to imagine a more important subject in the management of a practice. No firm can prosper or grow without satisfied partners. On the other hand, instability due to disgruntled partners can lead to nothing but problems—poor client relations, tension and distraction from productive work, and ultimately, dissolution of the firm.

The complexity of this problem relates directly to the size of the firm and the number of partners. It can be assumed that a two-partner firm can maintain communications and resolve problems without much of a formal system. It does, however, require some effort on the part of the individuals involved and perhaps a simple routine of regularly getting together for lunch or something of the like.

When the third partner comes into the picture an established system of communications is needed—probably a regular partners' meeting. The more partners there are, the more important this becomes. When the firm has more than one office the situation becomes even more involved.

In order to offer some concrete suggestions, the system used by our firm will be described. We have five partners located in two offices about twenty-five miles apart. While we are not all under one roof, we can get together without any undue loss of time or expense.

Our basic method of communication is a monthly partners' meeting. This meeting, usually lasting a couple of hours, is conducted with an agenda and with minutes prepared afterward. We discuss such topics as our work load for the next month, personnel matters, purchase of equipment, review of firm finances, and the like. The meetings are generally held during office hours, but occasionally in the evening. We normally meet in the office, but will sometimes meet in a partner's home. We do not permit the meeting to be interrupted by a client unless it is extremely important. All firm business of any consequence is conducted at these meetings and all partners are informed and participate.

At every third meeting the topic of practice development is on the agenda. A list of clients obtained and clients lost during the period is discussed and reasons for losing or obtaining clients are analyzed.

The monthly meetings are supplemented by an annual partners' meeting. This is an all day affair held at an out of town motel. This was set up to enable us to take a look at some of the longer-range problems facing the firm. We discuss five topics during the course of the day and each partner is assigned one topic to lead (for which he is expected to prepare in advance). Some of the topics discussed have been—

- What our objectives should be for the next five years.
- Methods of developing more estate work.
- Methods of developing more management services work.
- Review of billing practices and techniques.
- Review of future capital requirements of the firm.

The annual meeting is held at the beginning of the firm's fiscal year and one partner is assigned the job of preparing a firm budget for the year. This is reviewed and agreed upon or changed as necessary.

The annual meeting has proved to be a valuable tool in helping us to discuss problems and make plans outside the regular monthly routine. We find that we go away from this meeting with a better spirit and a firmer resolve to do a better job.

One important factor in relations between partners is knowing what is expected from each other, especially in chargeable hours and production of fees. This is reviewed in the annual meeting in connection with our budget. The number of chargeable hours of each partner is discussed in relation to his other obligations, both to the firm and outside. We set a goal of chargeable hours and fee production for each partner for the year.

It is also felt that partner morale and teamwork are improved if each partner develops some kind of specialty. We have not done too well at developing major specialties and all partners participate fully in auditing, accounting, and income tax work. We do have some minor specialities, however, and call on each other for expertise in the following fields:

- Wage and hour problems.
- Pension and profit-sharing plans.
- State sales tax problems.
- SBA loans.
- Estate and trust work.
- Data processing.

We look upon our partners' meetings as similar to those of a board of directors. It is here that policies are determined and decisions made. One partner is then primarily responsible for the management function, operating under the policies set in partners' meetings. This partner devotes a considerable amount of time and attention to management matters. We feel that the firm must be well managed if it is to operate efficiently and to grow. We also feel that our system keeps all partners as well informed and participating as fully as possible in firm business.

Our system is not offered as the final word on the subject and may not fit every situation. We feel that it works well for us. We haven't lost a partner in 20 years.

Partners' Retreats

Charles B. Larson

In 1974 we were facing a multitude of problems that most other firms face at some time. We had bickering among partners on the profit split and on the future of our firm.

At the Missouri MAP conference I had discussed the idea of a partners' retreat with a couple of other firms that had tried it. It sounded like an idea that made sense and, by coincidence, I had just bought a beautiful houseboat at the Lake of the Ozarks. Our first retreat was held in August. Sleeping accommodations were secured at a nearby resort and all of our business sessions were held on the poop deck of the houseboat. The retreat lasted three days and was all business. Our only concession to recreation was a leisurely evening meal. We held the partners' retreat at the lake for the next two years.

Although the first retreat was inevitably occupied with solving day-to-day problems, we made an effort to get our long-range plans in perspective as well. With each succeeding retreat our emphasis has been more on the future. As a firm grows, it passes the stage where day-to-day contact is sufficient for solid management and where long-range planning means partners "think alike." While the number of people or the amount of gross fees may vary among firms, in each firm's growth there comes a time when it is necessary to adopt more conventional management techniques. Invariably, the most important of these techniques is long-range planning.

The most difficult problem of long-range planning is, of course, getting started. The partner retreat is not only an effective technique to get a solid long-range plan initiated, but is also an excellent way to maintain communications and continually update the firm's long-range thinking.

At various MAP conferences that I attended around the country in 1975 and 1976, I noticed considerably more interest among practitioners in the concept of partners' retreats. I talked to many practitioners who had actually initiated the practice in their firm. Because I noticed a high level of interest in the retreats, I wanted to share the experiences of our firm and pass along comments which I have heard from other firms that have tried the partner retreat.

In many firms the partner retreat has become the most important single activity of the year. It is the activity that provides an opportunity to put everything in perspective. It's a once-a-year opportunity to stand back, away from the ringing telephone, staff interruptions, and client pressures and say "Where are we going?" "What are we really trying to do?" and "What have we actually accomplished?" It is a time to assess whether the firm's going up- or downhill.

Once in a while we should consider what else is going on around us. What's going on in the community? What's happened to our families in the last year? What's happened to our health? What's happened in the profession? In the next three to five years do we still want to be where we thought we wanted to be a year or two ago? Are things that we're doing now going to get us there?

Every competent CPA recommends that his clients have some form of long-range plan. He recommends that financial statements be used not only in a historical reporting sense, but as a basis for carefully considering the future. These same recommendations are doubly important for the effective conduct of a CPA practice.

In administrative reviews which I have conducted and in informal conversations at MAP conferences, it is startling to hear partners say, "We have never really sat down and discussed much about what we want or where the firm is headed." Lack of communication among partners has been identified not only as one of the most serious problems in CPA firms but one of the most prevalent.

I believe the partners' retreat can help to ensure solid lines of communication all year long.

Getting Started

How, then, do you go about planning a partners' retreat? The setting and the timing are important. Obviously, the retreat should be adapted to each individual firm as well as to the individual partners, but some general guidelines can be presented. The setting must be away from the office, in a place where there are no interruptions, no phones, and there is very little likelihood of running into friends or business acquaintances. Many firms have found a resort setting to be appropriate. Certainly the atmosphere should be comfortable, relaxed, and still businesslike.

Provide enough time so you are not hurried. By its nature, creative thinking cannot be forced. Two- or three-day retreats seem to be the most popular among many firms.

Arrive the night before. Get unpacked, settled, and enjoy a light dinner. Be sure materials and other arrangements are set up for the following day.

Perhaps the next day should begin a little later than normal business hours so that again the atmosphere is relaxed and unhurried. Many firms have found it helpful to devote approximately two-thirds of the day to business sessions. A period in the later part of the afternoon can be set aside for some form of recreation—swimming, golf, or even a long walk in the woods. A convivial social hour and a pleasant dinner provide an opportunity for informality and for various partners to exchange ideas on what has developed during the day.

Advance Preparation

The most important method of ensuring effective planning at the partners' retreat is the advance preparation. This should involve the development of all possible financial and statistical information in the firm's accounting and reporting system. Providing all partners with effective facts, statistical information, and comparative data, such as the development of trends in comparison with MAP surveys and the *MAP Handbook*, will ensure that the partners are on the same wavelength. If all participants have common data, the possibility of any misunderstandings can be eliminated. In the first development of such data, most firms are amazed that they really have not done as good a job as they assumed in developing solid information on which to manage their firm.

In some firms, the managing partner coordinates the preparation of a long-range planning guide, an annual report, or similar document that encompasses much of the above financial, statistical, and operational planning data. This "book" then becomes a partner's guide to the firm's operations for the next year.

A possible table of contents is shown in Exhibit 1.

In addition to the financial information necessary, it is important that the partner in charge of each area of the firm develop an analysis of his department's operations for the past year, as well as its plans for the future. A written analysis should ensure that each person has devoted the time and attention necessary to be specific, to really think through his responsibilities, and to communicate effectively to the other partners. It may be thought of as a report to the partnership. It provides a basis for next year's "action plan" for that practice area.

The report should include the major areas of activity of all departments. It may cover the practice development activities, forms and work techniques, personnel requirements, CPE plans, and facilities and equipment needs of the department. The depth and form will vary according to the size and management styles of various firms. Larger firms may have separate responsibility assigned for firm-wide areas,

Exhibit 1

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such as personnel or practice development. The managing partner will probably take the lead in presenting information related to the administration of the firm.

A key ingredient in the success of this activity is to be sure all the partners are involved in both development of this advance material and the entire planning process. For instance, it would be unwise for the managing partner to develop everything and bring it to the meeting in final form.

The Agenda

The goal of any meeting should not be just "to meet," but rather to accomplish specific purposes, and perhaps the best technique to this end is a good agenda. The agenda will vary among firms; but for a partners' retreat, the basic underlying purpose should be emphasis on the future. While it will be necessary to review past facts, this should be done only as a basis for discussing the future. Exhibit 2 presents a sample agenda.

Exhibit 2

Annual Retreat Agenda
May 1977
Lake of the Ozarks

		Subject	*Assigned to*
Sunday evening		Check-in and dinner	
Monday	9:00 A.M.	A review of the past year	
	10:15	Coffee break	
	10:30	Review of operations	
		Audit	
		Tax	
		G.A.S.	
		M.S.	
		Firm administration	
	12:00	Lunch	
	1:30	A review of the profession this year	
		Quality control	
		Metcalf & Moss reports	
		Other	
	3:00	Break—recreation	
	7:00	Cocktails and dinner	
Tuesday		Breakfast—individually	
	9:00 A.M.	Our community this year and next	
	10:15	Coffee break	
	10:30	Ourselves—the partners' reviews of developments and goals	
	12:00	Lunch	
	1:30	Conclusions—the future:	
		Where do we go? What do we do?	
		Wrap up	
	3:00	Break and leave for home	

The discussion may include the following topics:

1. An overview of the past year's operations—
   a. Financial results.
   b. Departmental plans (such as audit, tax and EDP) for next year.
   c. The operation of branch offices.
   d. The effectiveness of the firm's CPE program.
2. Some philosophical views of the practice—
   a. How many partners should be admitted in the next three to five years?

   b. Should the firm consider any mergers or acquisitions in the next three to five years?
   c. What kind of clients do we want to have three years from now, five years from now?
   d. What should be the role of the partners—
      i. In the firm?
      ii. In the community?
      iii. In the profession?
3. The partner's time commitment—
   a. To chargeable time?
   b. To CPE?
   c. To the community?
   d. To the profession?
4. Professional services—
   a. What do clients want?
   b. What is required by new laws?
   c. Where are new opportunities?
   d. What are we really interested in?
   e. What is profitable?

Outside Influences

What changes in the firm are going to have the most impact in the next three years? What changes in the community are going to have the most impact on the firm in the next three to five years? What are the most important new developments affecting the profession? How will our firm be affected? How will our firm react? These and similar questions can be used as a basis to stimulate conversation and to reach a meeting of the minds among the partners.

Changes in the Profession

What will be the impact of quality control—specialization, the pending change in accounting principles, monumental tax law changes and reporting requirements, such as ERISA? What will be the effect of increasing competition from the large firms? What are the implications of advertising? How will congressional inquiry affect our firm? What are the implications of antitrust?

Individual Goals

What are the present goals and long-range plans of each individual partner? What role does each partner want to play in the firm three years from now or five years from now? Which partners are interested in easing their load? Which partners are considering retirement? Which partners are interested in a six-month or twelve-month sabbatical?

Which partner would like to spend a year as a professor in a local university?

Who Should Attend?

Along with the partners, some firms have found it appropriate to invite senior staff members to certain segments of the meetings. This might be an appropriate time to invite a "partner-to-be" to sit in. It is a question that each firm will have to decide.

Follow-up

As with any planning exercise, it is important to follow up. From the partners' retreat a summary of "action points" should be developed. Any actions, plans, programs, or budgets agreed on should be clearly defined. If any new projects are assigned or any new duties have been agreed on, these should be spelled out.

One firm develops a brief overview of past operations as well as a summary of the future direction of the firm, in order to apprise the staff not only of the accomplishments of the firm but also its future direction. These firms have found that including the entire staff in long-range planning boosts morale and helps to encourage a cohesive work force.

Commitment

An open discussion is perhaps the most important single ingredient in an effective partners' retreat. At least once a year the partners should free themselves from daily routine and give some attention to the direction in which they are headed.

Often, the first partners' retreat can be a real eye-opener. If the partners really level with one another, they may find they are headed in entirely different directions. Identifying these differences at an early stage can eliminate a great deal of later dissatisfaction. If the partners identify their differences in direction, they will have an opportunity to deal with them realistically rather than to combat results of misunderstanding.

The many specifics of a partners' retreat are in the end rather unimportant. Where the retreat is held, what is on the agenda, or what specifics are dealt with are secondary factors. The really important thing is to be there, to devote the time and to think in terms of long-range planning. The specifics will flow from the character of the firm and the style of the partners. If the partners are committed to solid long-range planning and thinking, positive results are sure to follow.

Journal of Accountancy, *May 1975*

The Partners' Annual Meeting

Carl S. Chilton, Jr.

More firms are recognizing the benefits of holding some type of annual planning session. Some call it a "partners' retreat," others an "annual meeting"; whatever the name, the objectives are generally similar.

Our firm has been holding what we call an "annual meeting" for six years, and our partners are sold on it. We hold an all-day meeting at a country club in our area, after which our spouses join us for dinner. The meeting lasts one day, which sometimes seems too compressed, but we prefer to put in seven or eight productive hours at one time and be finished.

Partners are assigned to lead a discussion on some topic not related to the routine problems of the practice. The annual meeting is not a substitute for the regular partners' meetings during the year. We hold monthly meetings for the purpose of dealing with the current business of the firm: work load, personnel matters, staff training, and the like. The annual meeting stays away from day-to-day problems and deals with long-range or nonrecurring topics. Naturally, these various areas are interwoven and can never be fully separated, but the annual meeting has a completely different type of agenda from monthly meetings. The format and location of the annual meeting give it a unique flavor of its own.

Reasons for an Annual Meeting

The most important reason for an annual meeting is to plan for the firm's future.

Large businesses do a much better job of planning than small businesses, and the same can probably be said of accounting firms. The partners need to get away from the daily routine periodically. An annual meeting in different surroundings is refreshing and creates enthusiasm in all concerned.

The annual meeting improves communications among the partners. They all get the same word. They all have a better idea of what the others are thinking. Differences as to objectives become known and are discussed. When plans are made and objectives set, everyone has the same understanding of where the firm is headed.

Length of the Meeting

The length of the meeting depends on the size of the firm and the meeting's objectives. It could last anywhere from one day to several days, and could vary in length each year. A larger firm would probably require a longer meeting to accommodate more people and to handle more complex problems.

Another factor is the distance to be traveled to get to the meeting. If partners have to travel a considerable distance this would justify scheduling plenty of time, to be sure that everything is adequately covered and necessary traveling time allowed.

For a local firm, a one-day meeting has the advantage of requiring effective utilization of the time and getting back to work with only a minimum of interruption.

Timing of the Meeting

The meeting should be held near the end of the firm's fiscal year. Our fiscal year ends September 30, and we usually meet during the last half of October, after the books are closed. This provides time to prepare the next year's budget for presentation at the meeting. Firms with a December 31 year-end will obviously have some problems with this type of schedule and may have to meet prior to their year-end.

Specific Areas to Cover

The agenda for the meeting is limited only by the imagination of the partners.

One interesting topic covered at our meetings is a review of clients gained and lost during the year. A list is prepared of all new clients and the source of the engagement. This gives an insight as to who is recommending us—and who isn't. We also prepare a list of clients lost during the year and the reason for the loss. This gives us some idea as to what we are doing wrong.

Another important item is the review of the firm's budget for the coming year. A budget is prepared in considerable detail projecting the coming year's operations. This gives us a target for the year and a basis for measuring our performance as the year progresses.

An annual meeting is the ideal place for development of a five-year plan for the firm, projecting growth, personnel and office facility requirements, etc. This, of course, requires much thought and study and can't be handled in a brief period of time.

Other suggested topics for discussion are—

1. Ways of maintaining good client relations.
2. Effective utilization of partners' time.
3. Evaluation and review of partners' performance.
4. Various aspects of practice development, such as development of more work in estate planning, management services, profit sharing, retirement plans, and the like.

When the meeting is over the partners should have done more than just talk; they should have arrived at some objectives for the coming year. The budget will establish financial goals. Other goals can be set regarding personnel, office facilities, equipment, and the like. Responsibility should be assigned for attaining these objectives and the next annual meeting should review what has or has not been accomplished.

Benefits

Benefits from an annual meeting sometimes come unexpectedly. For example, at our last meeting, during a discussion on utilization of partners' time, an idea developed to have all partners prepare a written weekly schedule each Monday. This procedure is making us plan our activities better and letting everyone know when a partner is going to be out of town or tied up for some other reason.

Our meetings invariably bring us a feeling of cohesiveness and enthusiasm. We have a better idea of what we are accomplishing and where we are going. We have more appreciation of the contribution being made by other people in the firm. We have a better feeling of all working together toward a common goal.

Any firm can enjoy the same benefits. Even a firm with two partners could have an effective annual meeting, and the larger the firm, the more potential there is for achieving meaningful results.

Why Not Evaluate Partners?

Carl S. Chilton, Jr.

The practice of evaluating the staff personnel of accounting firms is widespread. This procedure is to the advantage of both the employee and the firm. It provides an opportunity to sit down with the employee and review his strong and weak points. There is an abundance of forms, questionnaires, and other material available to the practitioner who is trying to set up a staff evaluation program.

It would seem that if the evaluation of staff is important, evaluation of partners would be even more so. Partners are key individuals in any accounting firm, and the firm's success is based largely on how the partners perform. It also seems that partners, as well as staff, could benefit from an evaluation of their performance.

There is probably a feeling that a partner has reached a station where he should be free from evaluation by others. After all, who evaluates the owner or president of a company? The status quo is pleasant to enjoy, but it's probably not good for the firm. Even partners need some additional incentive to keep their performance up to par.

There is little material available, however, on partner evaluation. Hence, not many firms have a program of evaluating partners. There are firms that measure partner performance through statistical means: fee volume, number of new clients, writedowns, etc. Statistical measurements alone, however, lack one important ingredient of an evaluation program: the opportunity to review and discuss strong and weak points with someone else.

Our partners have discussed the subject of partner evaluation intermittently for several years. We found it difficult to get a handle on how to proceed. The idea of bringing in an outside party to perform the evaluation was attractive, but this approach had some drawbacks: it would be time-consuming and expensive and, finally, we didn't know who to get to do the job. We also considered some type of program for evaluating ourselves, or each other, but we figured this had a lot of potential for becoming a round of criticism of the other fellow's faults.

After considering the subject from time to time, we finally developed a list of responsibilities against which partner performance could be measured (see the exhibit). At first this list was used to help us sharpen our thinking about areas of responsibility. But then we began to think about using it for partner evaluation. We considered the idea of having each partner evaluate each of the other partners, with the evaluation sheets to be sent to an outside party who would summarize the results and return them to us for discussion.

Another approach we considered was for each partner to evaluate himself, with the results to be reviewed and discussed among all partners. After considerable discussion, it was finally decided to use this approach.

The meeting at which we reviewed and discussed the evaluations was quite productive. The plan was for each partner to state his rating of himself on item 1 (see the exhibit), for example, with the reasons for the rating. Other partners made comments concerning certain strong and weak points. This discussion had to be handled with considerable tact and finesse, of course.

We found that we were able to bring out various points that would have been difficult to mention under ordinary circumstances. Each partner found himself in a position of frankly stating where he thought he had done a good job and where he had fallen down. Suggestions were made that would improve the performance of all concerned.

The exhibit reflects the ratings actually given by our five partners. It is worth noting that the ratings ranged all the way from 1 to 4, indicating that the evaluation was made after serious thought and with as much objectivity as could be expected.

No attempt was made to arrive at an overall rating or ranking among the partners. One reason for this is that the 14 areas of responsibility are not of equal importance and we made no attempt to rate the importance of each. Further, our objective was to improve performance of each partner. We were not trying to rank the partners in relation to each other.

We found that one of the biggest advantages of this project was that each partner was required to think seriously about his own performance. This made each of us more cognizant of our areas of responsibility as well as our strong and weak points.

We feel that partner evaluation was a worthwhile project and will probably do it again in a year or two. We may not use the same procedure, but the procedure isn't as important as the attitude—the willingness of the partners to take a look at themselves and discuss the results with their peers. We got some real good out of it and feel any firm would do so also.

Evaluation of Partner
Responsibility and Performance

	Rating				
Workload, production, and firm responsibility	A	B	C	D	E
1. Fees produced by partner's clients	3	3	2	2	1.5
2. Profitability of work done for clients (write-downs, etc.)	4	1	2	2	2
3. Fees produced by partner individually	3.5	2	2	2	1.5
4. Effectiveness in collecting client receivables	1.5	2	2	2.5	3.5
5. Performance and up-to-date knowledge in basic areas of practice (tax, audit)	2	3	2	3	3
6. Performance and up-to-date knowledge in specialized areas (data processing, estate work, pension plan work, etc.)	2	3	3	3	3
7. Performance in contributing to the management of the firm	3	2	3	2	3
Client relations					
8. Reputation for "attentive" service	3.5	3	3	2.5	2.5
9. Ability to complete work promptly	3.5	1	1.5	1.5	1.5
10. Availability to clients when needed	3.5	2	2.5	2.5	2
Standing in the community and the profession					
11. Image in the community as a top-level citizen and professional man	2.5	3	3.5	3	3
12. Positions of leadership in community organizations	2.5	3	2	3	3.5
13. New clients brought in through individual contacts and efforts	3	3	2	2	3
14. Standing within the profession (positions of leadership, etc.)	3	3	1.5	3	3

Rating system

1. Poor
1.5
2 Satisfactory
2.5
3 Good
3.5
4 Outstanding

1.5, 2.5 and 3.5 are "in between" the described ratings.

Evaluating and Rewarding Partners

Norman S. Rachlin

Once a partner achieves a percentage interest or points or units in a firm, should that share remain at a constant level forever? Our firm thinks not and, further, has adopted a method for regularly rewarding partners for outstanding contributions to the firm.

First of all, each partner has a base draw (or "salary") and any profit remaining above the draws is divided on the basis of points. Points are also used as the basis for determination of a partner's payout in the event of death or retirement. The initial number of points is based on original contributions to the firm (in clientele and/or capital), or points are allowed to be purchased on admittance to partnership.

More points can be acquired from the firm by award in the following manner. At the end of each year the firm considers it has available one point for each $1,000 of annual volume and can award those points not already outstanding. If we assume an annual volume of $750,000, then—

Points available (total authorized)	750
Total of partners' present points (issued)	525
Points available for distribution	225

The firm now has 225 points available to distribute to present or new partners. (This can be thought of as similar to shares of stock in a corporation.) They can be awarded (issued) or carried over to subsequent years, depending on the recommendation of the Points Committee.

At the partners' December meeting each year, two partners are selected (by secret ballot) to serve as the Points Committee. At the

January partners' meeting the Committee presents its recommendations as to awarding points. If there is no veto by 75 percent or more of the partners, then the recommendations of the Points Committee shall be effective for the year beginning January 1.

The first time the Points Committee met, it found it had no criterion for awarding of the points. The initial committee awarded no points, but it did develop an "evaluation analysis" (see Exhibit 1). This analysis is based on a partner performance list given by Carl S. Chilton, Jr. and on material presented by William R. Shaw.

The "evaluation analysis" is prepared three times a year by each partner on himself and each of the other partners. The analyses are submitted to the managing partner, and he is authorized to review any deficiencies or "downward trends" with the subject partner. At the end of the year these forms are made available to the Points Committee as a basis for judgment in awarding points.

The analysis is prepared several times during the year to provide the committee with representative reports on the partners. It was believed that a single report for the year would be unduly influenced by either a particularly good or a particularly bad act occurring just prior to evaluation time.

There are six categories available for scoring an evaluation:

0 No basis for judgment.
1 Disappointing, needs improvement.
2 Erratic, less than expected.
3 Satisfactory, normal expectancy.
4 Excellent, unusually well done.
5 Outstanding, rarely equaled.

The 31 items of review are divided into five major categories:

A Workload, production, and firm responsibility.
B Client relations.
C Personal development.
D Standing in the community and profession.
E General.

In addition to specific areas of judgment, the form also provides for subjective comments on outstanding accomplishments, areas of weakness, and efforts to resolve weakness.

Returning to our example, the Points Committee would review the three evaluation forms on each partner for the purpose of awarding the 225 available points. (Potential partners, principals, and managers are also evaluated by the partners but are not involved in awarding of

Exhibit 1—Evaluation Analysis for Partners, Principals, Managers

Analysis of__________ Period covered__________	No basis for judgment	5 Out-standing, rarely equaled	4 Excellent, unusually well done	3 Satis-factory, normal expectancy	2 Erratic, less than expected	1 Disap-pointing, needs improve-ment
A. *Workload, production, and firm responsibility*						
1. Fees produced by partner's client responsibility						
2. Profitability of service for clients (considering hourly rates, markdowns, markups, etc.)						
3. Fees produced by partner individually						
4. Effectiveness in collecting client receivables						
5. Performance and up-to-date knowledge in basic areas of practice (what every partner is expected to know)						
6. Performance and up-to-date knowledge in his specialized area						
7. Performance in contributing to the management of the firm						
8. Engagement planning and control						
9. Ability to get things done						
10. Ability to delegate and supervise						
B. *Client relations*						
11. Reputation for "attentive" service						
12. Ability to complete work promptly						
13. Availability to clients when needed						
14. Confidence in him and satisfaction with work						
15. Expansion of service to existing clients						

C. *Personal development*					
16. Participation in recruitment					
17. Participation in training programs					
18. Efforts to bring along subordinates					
19. Attitude toward employees					
20. Employee attitude toward person evaluated					
D. *Standing in the community and profession*					
21. Image in the community as a top-level citizen and professional					
22. Positions of leadership in community organizations					
23. New clients brought in through individual contacts and efforts					
24. Standing within the profession (positions of leadership, etc.)					
25. Participation in professional activities					
E. *General*					
26. Self-motivation (initiative, drive, energy)					
27. Leadership (ability to motivate others)					
28. Stability and maturity (discerning what is important, reliability in crises)					
29. Judgment (when to decide and when to consult)					
30. Cooperativeness and team play					
31. Promotion of firm's standing					
Totals *(Maximum score 155)*					Grand total

(Total the number of √'s in each column and multiply by the digit (1–5) appearing at head of column. Add the column totals across to obtain the grand total.)

Exhibit 1 (continued)—Narrative portion (if desired)

1 Outstanding accomplishments of period since last evaluation __________

2 Major areas of weakness __________

3 Efforts to resolve weakness __________

4 Other __________

Date __________ Prepared by __________

This form is to be completed and submitted to the managing partner on a confidential basis. The completed sheets are to be retained for submission to the Points Committee at the end of the year. At his discretion, the managing partner should review with the person evaluated any consistent scoring in the last two columns.

points.) Assuming that all 225 points were awarded, the results could be as shown in Exhibit 2.

There are three key ideas which make this system of awarding points effective:

1. It is a method of rewarding the younger partners on a regular (annual) basis, to keep their enthusiasm high, and it allows them to share in increased profits.
2. Points are awarded only out of growth of the firm (if the annual fees did not increase there would be no new points available).
3. Once awarded, points are never taken away, so no one feels that he or she has surrendered anything.

The points system outlined above is the method which we use to evaluate and reward our partners on a regular basis.

Exhibit 2—Awarding Available Points

	Present			*New totals*	
Partner	*Points*	*Percent*	*Awarded*	*Points*	*Percent*
A	250	47.6	50	300	40.0
B	100	19.0	50	150	20.0
C	75	14.3	75	150	20.0
D	75	14.3	25	100	13.3
E	25	4.8	25	50	6.7
Total	525	100.0	225	750	100.0

The Revolving Door for Partners

J. Robert Shine

Our firm is an outgrowth and continuation of a firm which started in 1925. The present partnership started in 1963 with 3 partners, 2 of whom are left. Since that time we have admitted 5 partners, 4 of whom are left. Our experience appears to be typical of other firms. This article will address the problems of reducing partner turnover and improving partner performance.

There are many advantages in a permanent partnership. Among them are the following:

- The building of a strong organization and clientele.
- Presentation of an image of stability to the public and financial community.
- Providing for succession and financial security for partners and staff.
- Maximizing efficiency and profitability in serving clients.

To keep the partnership permanent, a firm should recruit the best personnel available and give them the best training. Some will eventually show partnership potential. A partnership must have a strong agreement and follow a sound selection process for partners. It is important to keep good communications among partners and others in the firm. We also insist that all members of the firm (partners and staff) refer to the firm's practice with the plural pronoun "we," never the singular "I." It is essential for all partners to be tolerant of what they may consider to be the faults of other partners. Our firm discourages discussion of firm affairs outside the office. Gossip has destroyed more than one firm. Finally, to keep a partnership permanent, it is necessary to weed out the partners who do not perform.

The question of whether the number of partners should be fixed is often raised. It is the feeling in our firm that individuals otherwise qualified should be admitted without regard to numbers. It is necessary for the large firms to limit partners in relation to volume, staff members, or other objective criteria. In a smaller firm, however, we believe if an individual is otherwise qualified for partnership, he or she should be admitted. If there are too many chiefs, perhaps some of the present partners should be eliminated. The more qualified partners who remain to continue the practice, the greater the assurance that maximum value will be realized. The firm that limits its partners limits its growth.

Partner Selection

The selection process for partners must follow the basic firm philosophy agreed to by the present partners. The first element of any firm's philosophy is that all partners should be committed to the firm's "concept." Current and future partners should have wholehearted commitment to the firm's goals and procedures. Also, when all the partners agree to a change, everyone in the firm should follow the new policy—whether it is a change in firm philosophy, procedure, or otherwise.

It is generally desirable to select partners from the staff rather than bring in outsiders. It is important to know as much as possible about a potential partner in advance. Also, bringing in an outsider may affect the morale of the present staff. It may be necessary at times to go outside when the firm needs a specialist not available on the staff, but even greater care should be followed in that selection process.

A prospective partner should be enthusiastic. The individual should like his or her work and the profession, should be a doer and not a doubter, should possess sound judgment and know when to decide and when to consult, and should have strong technical skills, including the ability to speak and write well. Special emphasis must be placed on the communication skills because it will always be difficult to reward an individual who cannot properly convey his or her thoughts. A prospective partner should be able to plan, program, and complete assignments; persevere in problem solving; and should initiate and follow his or her own program of self-development.

A prospective partner must have desirable personality traits, and the most important are unquestionable integrity, loyalty, and high motivation. The ability to work well with people, including supervision, training, and reviewing the work of others, is also important. A potential partner should have high professional values, dedication to the firm and clients, a sense of civic responsibility, and the ability to acquire, develop, and retain clients. An individual ready for partnership should have good administrative ability, the ability to delegate, the ability to lead, and the ability to work under pressure. The individual should be stable and in good physical and emotional health. Evidence should be available to show that the person is in control of his or her own life and has a stable family relationship. A partner must be completely dependable. The prospective partner should be old enough to have a proven track record, but young enough to have many years of service ahead.

There are some personal characteristics of a prospective partner which may indicate partnership should not be offered. If even one of these qualities exists, more problems may be created than solved if the person is admitted. An individual who has excessive independence, who works well alone but has difficulty working with others, will not work out. This is a violation of the "firm" concept and the first rule of partnership. If an individual is self-centered, he or she will not be appreciative of or cooperative with the objectives or policies of the firm. An individual who is indecisive, who lacks dedication, or has some social maladjustment should probably also be struck from the list. Finally, if a prospective partner does not have a strong proprietary interest, he or she is probably not the type of individual who should be added to a firm. Do not compromise partner selection to solve a short-range problem. The cure may be worse than the disease. An individual who does not measure up prior to admission to partnership will probably become a problem after admission. It may be better to lose the staff member rather than to admit such a partner.

Prior to admission to partnership, the prospect should be carrying out advanced client responsibility. The prospect should have complete responsibility for major clients and should be concentrating all efforts at the review and supervisory level rather than at the field level. The individual should hold a management conference with the client at the conclusion of the engagement and should write a meaningful management letter to the client on each engagement. The client should be calling and depending on this person for service.

The potential partner also should have assumed some administrative responsibility, such as recruiting or staff training. In our firm we use such titles as staff accountant, senior accountant, supervising senior, supervisor, and partner. Each week we hold a meeting of what is called the "management group" (which includes the categories of supervising seniors, supervisors, and partners) where problems of the firm are discussed. This gives those who are not yet partners an insight into firm problems and firm decisions. It also gives the firm the advantage of their input, which is often helpful since it is generally from a staff viewpoint rather than a partner viewpoint. We have found these meetings helpful to condition prospective partners for admission to the partner group.

The authority for admission of partners should appear in the partnership agreement. The number of partners authorized to make the decision should be limited to the smallest number practical in each partnership. It is our belief that partners are not equal. There are no two partners in our firm who receive the same compensation. Whenever we bring in two partners at a time, we deliberately compensate them differently to avoid any possibility of tracking one on the other. We require new partners to invest capital in full upon admission. We will make arrangements, if necessary, with a bank so that the new partner can secure the necessary funds. The new partner should receive a substantial improvement in compensation.

Partner Evaluation

We believe the evaluation of partners on a periodic basis helps to improve partnership performance. Some firms use an outside consultant, but the reviews in our firm are conducted by the managing partner. We use a management-by-objectives program whereby each partner, as well as each staff person, sets goals for each six-month period. The managing partner meets with each of the partners and staff semi-annually to review the performance of the last six months and to set goals for the next six months. Personal goals are always aligned in accordance with firm goals. We use a special form in connection with the evaluation process for members of the management group. We give greater credit in our firm for productivity than for intangibles. For example, each partner is required to set goals for chargeable hours and new clients. By use of the goal setting process, each partner is able to tell if his or her performance has been acceptable.

The Problem Partner

The causes of the problem partner are numerous. It may be the person should never have been admitted or has not kept pace with the growth of the profession or the firm. In some cases an individual may develop medical or personal problems. We require all new partners to have a physical examination with a report to the managing partner before admission to the partnership. Other indications of the problem partner, in addition to not having met the goals set, may be that the individual does not share the load, does not work toward firm goals, does not develop people or clients, or does not maintain technical skills. If problems arise with a partner, the firm should take positive corrective action. Be sure to have a partnership agreement which provides for expulsion and minimizes the cost.

Withdrawal of a partner should be set forth in the partnership agreement on both a voluntary and an involuntary basis. A partner should be permitted to withdraw on a voluntary basis only after several months notice has been given and at times during the year that will not conflict with the peak load. A retiring partner should agree to relinquish all right to partnership assets, including files and clients. Generally the tax interests of a withdrawing partner and the remaining partners are diametrically opposed. In most agreements, the interests of the remaining partners are the dominating factor in withdrawal provisions. If the withdrawing partner has a substantial investment in the firm, advantages to the partnership exist in a long-term payout. Our firm's philosophy is that a newer partner who is withdrawing should receive the cost of investment and accumulated earnings only, and an older partner an amount similar to what would be received as retirement benefits.

The expulsion of a partner should be authorized by the same partners permitted to authorize the admission of a partner. A written agreement should be prepared which will limit the ability of the departing partner to take clients. A serious public relations problem can exist if the partner is being discharged for reasons not clear to the clients or the public. Every effort should be made to keep the goodwill of the departing partner and also of the clients he or she served. Some extra attention in this instance will almost always have to be paid to relationships with banks and attorneys as well.

A Successful Partnership

We have presented in this article some thoughts on the maintenance of a strong partnership. This topic is not an exact science and there may be other approaches. For a successful partnership, remember to—

- Adopt, develop, and nurture the firm's "concept."
- Recruit and train on the highest level to develop personnel who may bloom into partners.
- Use high standards for selection of partners.
- Use partner evaluation and weed out those who do not perform.

Profit-Sharing Arrangements in Small Firms

The problem of profit allocation arises in three basic situations:

1. The admission of a new partner.
2. The acquisition of a practice through merger or purchase.
3. Retirement of a partner.

Let us assume that we have before us key information on that now famous partnership of A, B, and C. These partners have been together for some years, and all profits, after partners' salaries, have been divided equally. In Schedule I, their gross fees and profits have been as shown in the column headed Base I.

They now desire to admit D as a partner. They want to give him a profit-sharing arrangement which will amply reward him, and yet take nothing from the three senior partners. D is therefore brought into the partnership and his share of the profits, after salaries, is determined as follows.

Schedule I

		Base I		*Base II*		*Total*
Fees		$100,000		$50,000		$150,000
Ratio		66⅔%		33⅓%		0%
Net income after partners' salaries		$ 20,000		$10,000		$ 30,000
Partner A	33⅓%	$ 6,667	25%	$ 2,500	30.5%	$ 9,167
B	33⅓%	6,667	25%	2,500	30.5%	9,167
C	33⅓%	6,667	25%	2,500	30.5%	9,167
D			25%	2,500	8.5%	2,500
Total	100%	$ 20,000	100%	$10,000	100.0%	$ 30,000

The gross fees for the first year after admission are shown in the column headed Total, and the increase in the first year of the new partnership over the preceding year is shown in the column headed Base II.

The partners agree that the net income will be divided in proportion to the gross fees, and the net income for this first year, $30,000, is divided between Base I and Base II in proportion to the gross fees. Therefore, $10,000 is allocated to Base II and this is divided among all partners equally.

It is the belief of the partners that the future success of the new firm will be the results of the combined efforts of all partners, and, consequently, all partners should share equally in the growth.

Using this basic concept, many arrangements can be developed to suit the particular problems and situations which some practices might have.

One objection which might be raised to this plan is that since profits are allocated on the basis of gross fees, there might be a temptation for the newer partners, who share only in profits other than Base I, to hang onto and encourage low fee engagements which increase gross fees but do not increase the net profit. This could work to the disadvantage of the Base I partners who would then find their share of the profits decreasing. This objection could be overcome by specifying in the agreement that the net income after partners' salaries for Base I will be its pro rata share but not less than a fixed amount—$20,000 as in Schedule I.

It is possible to use an average figure for the gross fees. For example, the fees for Base I could be the average of a preceding period, say three years. The total fees, before allocation of fees and profits of Base II, could also be based upon a three-year average—for example, include the two years before the admission of D and the first year D is a partner. This tends to dilute D's share, and several years would have to pass before he would feel the full benefit of his efforts.

Some firms choose to divide their partners into two groups, seniors and juniors, with management responsibility and capital belonging to the senior partners. These senior partners would then be in Base I, with the agreement that a new partner would be shifted to Base I when ready.

Suppose, for example, that several years pass by and it is the desire of the partners to promote D to a senior partner and to expect him to share in the responsibilities of management and capital. The figures in Base II could then be shifted to Base I.

It is possible for a junior partner to be shifted gradually to Base I.

Let us now assume that Partner E is to be brought into the firm through a merger, that E's gross fees for the purpose of profit-sharing computation are $50,000, and that he is to be equal in management and

Schedule II

		Base I		Base II		Total
Fees A, B, C, D		$100,000		$50,000		$150,000
E		33,333		16,667		50,000
Total		$133,333		$66,667		$200,000
Ratio		66⅔ %		33⅓ %		100%
Net income after partners' salaries		$ 26,667		$13,333		$ 40,000
Partner A	25%	$ 6,667	20%	$ 2,666	23⅓ %	$ 9,333
B	25%	6,667	20%	2,666	23⅓ %	9,333
C	25%	6,667	20%	2,666	23⅓ %	9,333
D			20%	2,666	6⅔ %	2,666
E	25%	6,667	20%	2,666	23⅓ %	9,333
Total	100%	$ 26,667	100%	$13,333	100%	$ 40,000

capital with partners A, B, and C. The profit-sharing arrangement would then work out as shown in Schedule II. Future growth of the practice would then be worked out on a Base III.

If, on direct purchases of practices, the payout requirements are to be made out of current collections, it is likely that no profits will be earned until the payout is completed. It is suggested that the gross volume in such a situation not be included in any Base computations until the purchased practice has become profitable.

If a partner desires to retire, there are a number of arrangements which can be worked out. Let us assume that Partner A in Schedule II wishes to retire and Partners B and C wish to purchase his equity. For Base I, Partner A would receive $33,333 (25% of $133,333) plus $13,333 (20% of $66,667), or a total of $46,666. Partners B and C could then negotiate with A for a payout to be made in several ways. One would be to permit A to draw his share of the profits, but not his salary, until these withdrawals equal the amount they have agreed he should get. This might be the $46,666 mentioned above, or, under some circumstances, it might be agreed that his interest is worth more or less than this amount.

If B and C were not interested in acquiring a heavier investment in the practice, it is possible that a younger member, such as D, might take over A's interest, paying off A by foregoing his newly acquired share of the profits until A has withdrawn the negotiated amount. Also, A's interest might be transferred to and divided among several partners, depending upon circumstances.

What Is a Good Managing Partner?

Richard C. Rea

It is Professor H. Edward Wrapp's opinion that much of the literature and teaching about management has created an image of a manager which does not exist. In the September–October 1967 issue of the *Harvard Business Review,* he takes exception to some widely held notions about what a manager's life is like.

Notion 1. Life gets less complicated as a manager reaches the top of the pyramid.

Notion 2. The manager at the top level knows everything that is going on in the organization, can command whatever resources he may need, and can therefore be more decisive.

Notion 3. The manager's day is taken up with making broad policy decisions and formulating precise objectives.

Notion 4. His primary activity is conceptualizing long-range plans.

Notion 5. In a large organization the chief executive may be seen meditating about the role of his organization in society.

The title of Mr. Wrapp's article is "Good Managers Don't Make Policy Decisions."* I don't think Mr. Wrapp really means this, but, since he is an iconoclast, he takes delight in destroying the conventional prototype of a general manager.

While his article is directed toward business, I have adapted it to the management of an accounting practice. I am sure there are others who were disturbed, as I was, to discover that they could not identify with the prototype manager as described in texts and business literature. My enthusiasm for Mr. Wrapp's article may result from the fact that his ideas about the way a manager manages correspond more closely to the way I run my own firm than do the procedures described in most textbooks.

Those of you who are managing partners and have been uncomfortable because you failed to measure up to the textbook image should take heart, as I did. Mr. Wrapp says we are not nearly so wrong as we thought we were.

To those readers who are not managing partners but who some day might be, I recommend this article for serious study. But even those who may never be managing partners will benefit from the article if they acquire a better understanding of the difficult and often lonely task of the managing partner.

Awareness

A good managing partner must know what is going on at all levels of his organization, but he does not usually acquire this knowledge by command. To get it he must cultivate sources of feedback from lower levels, even bypassing the conventional lines of authority if necessary. He is sensitive to "scuttlebutt" and is skillful in reading between the lines in conversations with his staff.

He will involve himself enough in detail operations to keep the feel of the organization so that he does not have to depend entirely upon the information he receives from his partners and staff, and can check this information against what he already knows.

Decision-Making

He knows how to conserve his energy and time for those issues, decisions, and problems which should be given his personal attention. Those which he decides are not important enough to warrant his attention he delegates to others whom he has trained to act without his approval. He is not indifferent to such issues. The communication he wants to receive is, "Here is the problem, and this is what I propose to do." If his partners and staff suspect that he might not be in total agreement with a decision they are considering, they will inform him before they announce it. However, he will usually know that the decision is in their minds and has already decided whether to support it, defer it, redirect it or block further action.

He must master the fine and subtle art of distinguishing between those decisions which should be delegated and those which should not. He must not allow the organization to force him into participating in minor decisions or, even worse, in making them. Recognizing that he can bring his special talents to bear on a limited number of matters, he chooses for himself only those issues which he believes will have the greatest long-term impact on the firm and those in which his special abilities can be most effective. Hence he limits himself to three or four major objectives during any period of sustained activity.

He is sensitive to the interplay for status and the jockeying for influence in the firm. In considering a major proposal, he can anticipate the positions various members of his staff will take, ranging from enthusiastic support to outright opposition, even though the opposition is often well cloaked.

He has mastered the skill of arranging for trial balloons, and to do this he has cultivated certain members of the staff on whom he can depend for this purpose. He studies carefully the reactions of others to these trial balloons and is ready to decide whether or not he will proceed.

He knows that if any issue evokes support it will also develop opposition. Few major decisions receive 100 percent support, or even close to it. He is aware that the organization will tolerate only a certain number of directives from the top, and he does not waste these limited opportunities on issues on which the staff is sharply divided. He knows there are issues that lie in what Mr. Wrapp calls "corridors of comparative indifference," since they do not evoke marked reaction. In these corridors he can operate effectively.

The good manager has a fine sense of timing. Even though a highly debated issue seems important, he may decide it is not timely to issue a directive while feelings on the subject are strong. If he is patient, other matters will soon preempt the attention of the staff, and what was once an issue on which the staff was sharply divided will eventually fall into one of those corridors of comparative indifference. He can then take positive action.

Goals and Objectives

He knows the goals which he wants his firm to achieve, even though the outline at times may be hazy. Consequently, his timetable is also hazy except that he knows instinctively that some objectives must be accomplished sooner than others and that others may be safely postponed. His instinct tells him when the right time comes to act on them. He may have an even hazier notion of how he intends to reach his goals. But this haziness is not a disadvantage, since he also knows that it is not advisable to be too precise about his firm's objectives and goals. It is impossible to set down specific objectives which will be relevant on a long-range basis. Too many factors come into play which upset precise plans and programs. He must therefore keep his program broad and flexible so as to adapt to these changing conditions.

He knows that it is difficult to state objectives so clearly that everyone in the firm will understand what is meant. Specific objectives can best be communicated over a period of time by their consistent application in the firm. These objectives are then meaningful when they are finally put into words. Those who keep pressing for more precise objectives are in truth working against their own best interests. A premature statement of specific objectives will limit the range of thinking of staff members. By narrowing the field less room is available to accommodate the flow of new ideas through the organization. These ideas are important and he must not do anything to discourage this flow. Also, a premature statement of precise objectives can be interpreted differently by each member of the organization, causing confusion and misunderstanding.

The good managing partner knows that each member of the staff, or groups of the staff, can have his own set of goals and ideas about which way the firm should be heading. He knows about some of these and suspects the existence of others. He also knows that dedication to their own ideas can cause these groups to block his programs or projects if he brings them out into the open at the wrong time. He must therefore wait until his programs are in one of the corridors of comparative indifference before he takes action.

Policy Decisions

The good managing partner has learned to be slow in formalizing policy decisions even when there is favorable support. He knows that a prematurely issued policy can cause more problems and disputes than it settles. Often he will have a policy in mind for a long time before it is imparted to his partners. He knows it must be tested and, for all practical purposes, be in use before he states it specifically. This does not mean that the well-managed firm operates without policies. But those major policies which are in effect were evolved over a long period of time and grew slowly from a conglomeration of minor operating decisions.

The good managing partner has learned that many of his major decisions must be communicated to the organization in small doses, a conditioning process which may stretch over months or even years, in order to prepare the organization for radical departures.

Suppose, for example, that the managing partner is convinced his firm must phase out of write-up work. He may feel that he cannot disclose this decision even to his partners if they are deeply involved in write-up work. A blunt announcement may be too great a shock for them to bear. And so he begins moving toward this goal a little at a time, without making a full disclosure. A detailed statement of his ultimate objective would only complicate the task of reaching it. Specific detailed statements will give those who would be opposed an opportunity to marshal their arguments against such changes.

The successful managing partner recognizes the futility of trying to push completed programs through the organization. He must be willing to settle for less than total acceptance of his ideas, and he must be satisfied with modest achievement. He is willing to go slowly. He avoids debating on principles and tries to piece together ideas and methods that may appear to be incidental to the utlimate goal but can be shaped into a program that is moving toward his objectives. He is a confirmed optimist, with a high degree of persistence and monumental patience.

Innovations and Changes

He is a man of wide-ranging interests and curiosity; the more he knows about how other firms are operated, the more opportunities he will have to discover ideas and methods which he can piece together. These opportunities he seeks out at state and national conventions, professional development courses, and even chapter meetings. This seeking out does not require great intellectual brilliance or unusual creativity, but it does require some skill as an analyst and some talent as a conceptualizer and innovator. He must, of course, be a good listener.

A good managing partner can function effectively only in an environment of continual change. Consequently, he keeps his firm in a condition of continual change. Only with many changes can he discover new combinations of opportunities which open up new corridors of comparative indifference so a free flow of ideas throughout his staff is possible. He makes strategic change a way of life in his firm, and he constantly reviews his ideas and strategies and subjects them to repeated re-evaluation and criticism even though current results are good.

He continually sifts through the many incidents which make up the day-to-day and month-to-month operations of the firm, looking for parts that fit into the pattern he is trying to create.

The managing partner sits in the midst of a continuous stream of operating problems. His partners and staff will propose many solutions to these problems. In considering each proposal he will test it against at least three criteria:

1. Will the proposal, or even some part of it, move the organization toward the objective which he has in mind?
2. How will the proposal, or any part of it, be received by various members of the staff? Will there be strong opposition? Whence will it come? Which members of the staff will be neutral or indifferent?
3. How does the proposal relate to programs already in process or policies already proposed? Can some part of it be added to a program which already exists, or can several proposals be combined with parts of another proposal into a package which can be steered through the organization?

To sum it up, a good managing partner is able, under all conditions, to move his organization significantly forward toward the goals he has set. He is an executive, as compared to an administrator, whose principal role is to maintain the *status quo*. The good managing partner must be able to direct the introduction of a continuous flow of changes and innovations and still keep the organization from flying apart under pressure.

Journal of Accountancy, *September 1977*

What Makes a Managing Partner?

John W. Parson

Managing partners of CPA firms, although widely different personalities, exhibit basic patterns which are generally recognized by colleagues, clients, and subordinates.

All reflect a higher than average level of maturity, discriminating objective judgment, initiative, emotional independence, self-respecting attitudes, liking for others, and ethical responsibility.

All have strong achievement desires which they associate with work—the planning, organizing, and completing of a job well done. They have strong feelings that they must accomplish something if they are to be happy. This should be distinguished from the pseudo-achievement desires for personal happiness through rapid promotions, frequent increases in compensation, or rewards for high academic achievement in college. It isn't that successful partners do not gain pleasure from prestige, high earnings, contemplation of future ease, or long vacations (seldom taken). More real is the continued stimulation they derive from the pleasure of immediate accomplishment.

All successful managing partners have strong mobility drives. They feel the necessity to move continually upward and to accumulate the rewards of increased accomplishment. Finished work and newly gained competence provide them with a sense of continued mobility and professional recognition. The desire for accumulated earnings and the symbols of status which money can buy are highly motivating, but are secondary to the strong feelings of satisfaction derived from the completion of work per se. A reverse order in these drives would appear to point toward a breakdown of management effectiveness.

Decisiveness is another trait of successful partners. Decisiveness seems to be born from maturity of judgment and the ability to consider alternative courses of action, come to a decision, and act upon that decision—immediately or after detailed consideration. Seldom does this ability break down. However, when poorly directed and not modified by proper judgment, this trait can be more of a handicap than a help.

Emotional independence, initiative, and decisiveness are not qualities that result from years in school or experience on the job, but are rather the result of early conditioning through adolescence.

Conversely, the polite, amiable, overly cooperative, well-educated individual can exhibit a dependency and lack of decisiveness that stifles emotional growth, leadership, and promotional opportunities beyond that of a highly competent "doer of work." The compliant, dependent individual generally exhibits a shyness, often arising out of lack of self-esteem or deep-seated feelings of unworthiness which do not materially yield to change. They are fringe participants in group activities. They seldom have an opinion of their own which they feel strongly enough about to want to defend. If pushed into responsibilities they do not want, they seem to find ways to avoid such responsibilities. They may in time feel it is important to take part in community affairs, but the image they project seldom attracts clients to the firm that employs them.

The qualities which make an individual promotable are not only identifiable before hiring, but are quickly recognized by superiors and colleagues in the early stages of a career. As this kind of employee moves into higher and higher levels of responsibility, he continues to be regarded as promotable. This is why he has become a managing partner.

Partnership Agreement Checklist

The Texas Society of CPAs

I. Firm Name and Purpose

II. Duration of Partnership

III. Offices

IV. Ownership of Assets
   A. Furniture
   B. Office equipment
   C. Books and supplies
   D. All other assets

V. Accounting and Fiscal Year
   A. Cash basis
   B. Accrual basis
   C. Method for book purposes
   D. Method for tax purposes

VI. Capital
   A. Amount of contribution
   B. Method of contribution
   C. Voting rights—percentage representing a majority
   D. Minimum capital balances
   E. Annual determination of value of partnership for purpose of sale, etc.

VII. Meetings and Minutes
   A. Annual meeting
   B. Regular meeting

Reprinted from *Texas CPA*, 1971.

VIII. Salaries of Partners
  A. Partner and amount
  B. Provision for disagreements
  C. Expense of partnership
  D. Not an expense of partnership
  E. Meeting date for annual determination

IX. Partners' Loans
  A. Agreed rate of interest
  B. Repayment provisions
  C. Agreement on undistributed profits in excess of capital requirements, whether or not excess to be treated as partner loan

X. Division of Profits
  A. Consideration to
    1. Salaries of partners
    2. Interest on partner loans
  B. Basis and/or percentage of distribution

XI. Expenses and Damages
  A. Incidental to partnership affairs
    1. Shared on P & L distribution basis
    2. Provision for deficiency
  B. Resulting from willful negligence, dishonesty or fraud of a partner
    1. First charged against responsible partner's capital
    2. Excess against profits or losses before allocation
  C. Partnership shall carry, as an expense of operation, professional liability insurance with minimum limits of $______

XII. Salaries of Partners During Disability
  A. Temporary disability
    1. Amount less reduction for benefits from disability insurance
    2. Maximum period—beginning and ending
    3. Provision for participation in net income and/or loss distributions
  B. Permanent disability (see death, retirement, or withdrawal provisions): How determined—doctor certification, etc.

XIII. Admission of New Partners
  A. Admitted by majority vote
  B. New partner must execute partnership agreement

XIV. Death, Retirement and Withdrawal of Partners
  A. Reason—age, disability, voluntary withdrawal, involuntary withdrawal and death

B. Purchase and sale of interest
   1. Determination of partner's interest value including share of
      a. Partner's capital as valued annually
      b. Accumulated profits of firm for period since last evaluation of partner's capital
   2. Each partner binds himself, his estate, and his heirs to sell his interest as provided in this section

C. Annual valuation of partnership capital, tangible and intangible, shall be made by majority vote—percentage representing majority. If unable to reach current agreement, then prior agreement shall control

D. Agreement should state the income tax treatment to be afforded any payments made to a retiring or a deceased partner (IRC section 736)

XV. Retirement of Partner
   A. Age—mandatory
   B. Provision for payment for capital interest
      1. Amount of payment (in accordance with XIV(B)(1))
      2. Terms of payment
      3. IRC section 736
   C. Competition agreement from retiring partner

XVI. Voluntary Withdrawal and Sale of Interest
   A. Written notice—time limit
   B. Competition agreement
   C. Amount of payment
   D. IRC section 736
   E. Terms of payment—with or without interest
   F. Restriction of capital interest sale to anyone other than partnership

XVII. Retirement by Permanent Incapacity
   A. Same provisions as retiring partner except payment reduced by benefits received from disability insurance as provided by partnership
   B. Maximum period of absence constituting permanent incapacity

XVIII. Involuntary Withdrawal
   A. Association or affiliation with firm is detrimental to firm's best interest
      1. Determined by majority vote—percentage constituting majority
      2. Partner compelled to withdraw—with majority vote
      3. Covenant not to compete for firm's clients for a specified period

B. A partner whose CPA certificate is revoked shall withdraw from the partnership within 30 days

XIX. Effect of Death, Retirement, or Withdrawal
- A. Continuity of firm not affected
- B. No partner shall have right to compel dissolution of firm
- C. IRC section 736

XX. Executive Committee and/or Administrative Partner
- A. Large partnership (five or more partners)
  - 1. All partners by vote select an executive committee consisting of three or more partners. Executive committee, by vote, shall designate an administrative partner
  - 2. Executive committee shall not have power to
    - *a.* Reverse a previous vote of the partners
    - *b.* Remove or add a partner to the firm
    - *c.* Remove or add a partner of the executive committee
    - *d.* Change partners' salaries
    - *e.* Set the valuation of capital—tangible and intangible
    - *f.* Amend the partnership agreement in any manner
- B. Small partnership (less than five partners)
  - 1. All partners by vote select an administrative partner
  - 2. Administrative partner shall not have power to
    - *a.* Reverse a previous vote of the partners
    - *b.* Remove or add a partner to the firm
    - *c.* Change partners' salaries
    - *d.* Set the valuation of capital—tangible and intangible
    - *e.* Amend the partnership agreement in any manner

XXI. Conduct of Partnership Business and Partners
- A. Partners' outside activities
  - 1. Policy concerning services for any person, firm, or corporation being subject to executive committee and/or administrative partner approval
  - 2. Partner shall confine his active business efforts to partnership
  - 3. Determination as to time off allowed for vacations, professional development, etc.
  - 4. Determination of firm policy on nepotism
- B. Signing of statement with partnership opinion
  - 1. Must have approval of two partners

2. Evidence of two partner approval shall be firm's signed copy

C. General provision—conduct of partners: No partner shall, except in the ordinary course of partnership business

1. Employ or dismiss any agent or employee of the firm unless previously authorized
2. Give any security or promise of payment of money on account of the firm
3. Serve as bonder, bailor, endorser, or surety for any person, or knowingly cause or suffer to be done anything whereby the partnership property may be seized, attached, or taken on execution or endangered
4. Assign, mortgage, or otherwise impair his interest in partnership capital in any part
5. Draw, accept, or endorse any bill of exchange or promissory note on account of the firm except in the course of the firm's ordinary business
6. Buy, order, or contract for any property on behalf of the partnership except in the course of the firm's ordinary business
7. Make reports to clients without placing copies of reports in firm files
8. Undertake any firm business, the desirability of which may be questionable under general firm policies, without first submitting the engagement for approval by the executive committee or administrative partner of the firm
9. All differences as to policies shall be decided by a majority vote of the partnership interest, and no partner shall knowingly do any act in reaction thereto, contrary to the decision of the majority
10. Perform work which can be done just as well by a staff member except in the event of extenuating circumstances, or when the firm's best interests would be served thereby
11. Each partner shall at all times duly and punctually pay and discharge his separate and private obligations and engagements, whether present or future, and keep indemnified therefrom, and from all actions, proceedings, costs, claims, and demands in respect thereof, the partnership property and the property of other partners

12. Each partner shall at all times conform to the rules of professional conduct as set out by the American Institute of Certified Public Accountants, applicable state and local boards and organizations governing the practice of public accountancy
13. Engage directly or indirectly in any business either in the firm name or as a director or officer of a corporation or where any of his time could reasonably be expected to be required by the outside business, without the consent of his copartners as expressed by a majority vote of the partnership interest
14. Each partner shall treat the business of the firm and the business of the firm's clients and former clients in strict confidence and make certain that all papers, information, and data concerning same are cared for by himself (as well as those employees working with him) in a manner that will ensure their continuous confidential status
15. Undertake or continue to render any professional services for a particular client after being requested in writing not to do so by the administrative partner

This agreement is effective as of

Date ______________ ______________________
Partner

Date ______________ ______________________
Partner

Date ______________ ______________________
Partner

Date ______________ ______________________
Partner

Dissolution: Are You Ready for It?

Dan H. Hanke

With visions of sugar plums dancing in their heads, Black, White, and Grey inked their partnership agreement and a new accounting firm was launched.

A successful organization designed to stand the tests of time and the foibles of human nature was created. Since only a pessimist would contemplate the breakup of this team at this stage, a scant few sentences in their partnership agreement were devoted to that most improbable event: dissolution.

Oh, it was discussed. But the mechanics of such a matter are cumbersome and the circumstances so remote and difficult to predict that the three CPAs decided to leave these matters for determination when the need arises.

That scene is typical of most of our accounting partnerships. Because of this lack of advance planning or thought, bitter controversy needlessly arises in a dissolution. Leaving the mechanics of dissolution to be resolved at that later date might prove satisfactory. But the usual atmosphere is so strained at the time of dissolution that the problems are aggravated by the lack of advance agreements.

Litigation, arbitration, or, at best, an unnecessary delay in resolving an unpleasant circumstance are the most frequent results of our lack of advance planning.

The purpose of this article is not the proposal of pat answers. None exist. Each of us must examine his particular circumstances. While no formula can be proposed, there are some common problems for which your partnership agreement should provide in the event of a dissolution:

1. Division of net assets among partners.
2. Disposition of equipment and library.

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3. Completion of work-in-progress.
4. Collection of outstanding accounts.
5. Settlements of liabilities, particularly the following:
   a. Remaining obligations to retired or deceased partners or from practice purchases.
   b. Disposition of office lease and leasehold improvements.
6. Provision of continuity of service to clients through—
   a. Division of clients and files.
   b. Distribution of staff.

Since these problems are extremely complex, it is little wonder why many partnership agreements sidestep the resolution of these matters. But, again, the best time to set up fundamental rules is when the prospect is remote (and the willingness to reach a reasonable understanding is favorable), *not* when tempers have flared.

Obviously, the nature of your accounting partnership largely determines your solutions to these problems. Cohesiveness and age of the partnership are the true complications in settling liabilities and providing for service continuity. When two or more CPAs have a loose association where the clients look only to one practitioner for services, the firm name or reputation has in and of itself not attracted clientele, and purchases or retirements haven't created succession and liability problems, the disposition of intangibles is not troublesome and liquidation should proceed logically.

Contrast that situation to the established firm where services may be divided between specialists, the firm reputation has produced clients, partners have been promoted from within, and deaths and retirements have produced substantial liabilities. Here the intangibles which surround client disposition pose thorny problems.

Turning now to the specific points you should cover in your agreement, the division of "tangible" capital should produce few problems since this is an accounting problem. The capital accounts of the partners must be determined in accordance with your existing partnership provisions through the date of dissolution, and net assets distributed to each partner in satisfaction of his capital balance.

Winding Down the Work

The principal issues here are (1) equipment and library disposition, and (2) the division and/or collection of accounts receivable. To ensure equitable treatment of all parties in the division of equipment, the sale of equipment may be provided for, with the partners being given the first right of purchase at a price determined by independent appraisal.

The receivables division is subject to two principal solutions. First, the partners may appoint a partner or committee to supervise the collection of all accounts and the division of the proceeds in satisfaction of each partner's capital balance. Second, the receivables can be divided among the partners according to the division of work-in-progress and future servicing responsibility.

The latter approach probably will not be in proportion to the partner's capital balances and will necessitate the transfer of cash or notes among the partners to equalize the division of the receivables. However, the CPA who is continuing the services will probably have better luck in the collection process than a committee or individual charged with this task, but lacking the day-to-day client contact.

To the greatest extent possible, the work-in-progress should be completed prior to dissolution. On many accounts, this is not feasible and the remaining work-in-progress must be assigned. The work, naturally, is assigned to the CPA who will perform the future servicing. Your agreement should provide for the valuation of this work-in-progress as a partnership asset. Each CPA should have his capital account reduced by the value of assigned work-in-progress.

The division of work-in-progress brings us to the thorny problem in a dissolution: How do we divide our clients? Anything I state will be an oversimplification. But at the outset one point must be emphasized: clients are not chattels to be bartered over. They are not inanimate objects. No matter what their form of organization, our clients in the final analysis are humans.

Much of what has been written on the subject of client division overlooks this basic point. With our precise accounting minds, we forget that what appears to be perfectly logical to us in determining future servicing may be the exact opposite of our clients' desires. These desires, no matter how illogical, are the final determinants of servicing.

My suggestion to you, therefore, is to carefully provide for client consultation on the assignment of services and for a means of monetary adjustment among the partners for inequitable client division caused by these human factors.

Clients Aren't Chattels

Just as all marriages don't work, some accounting partnerships will fail and fairly quickly. Where two or more existing practice units merge, the agreements should allow an easy unbundling during a transitional period.

One device which has been used successfully is to designate the clients originating in each practice unit and provide that those clients will be serviced by the originating CPA(s) should a dissolution occur within three years. This then leaves only the more minor problem of clients acquired subsequent to the merger. The disposition of these clients could be handled in a manner similar to the handling of the division of an older practice discussed below.

In dividing "firm" clients, your agreement may only provide a framework or set of guidelines, since the exact composition of the clientele in the event of dissolution is unknown. Mechanically, the agreement should designate (1) those members of the partnership who will make an initial determination of future servicing, (2) criteria which they should use in account assignment, (3) the method of obtaining client agreement to the servicing arrangement, and (4) the method of valuing client relationships for purposes of settlement should some partners receive a greater proportion of business than their capital interest.

In addition, the partners may find a cooling off period desirable, during which the partners agree either (1) not to service clients assigned to the other partners, or (2) to service those clients only after the payment of a licensing fee to the first partner.

The agreement must provide that all files and work papers are retained by the CPA charged with future service. Naturally, each partnership will set criteria, valuation methods, client consultation procedures, and competitive limitations geared to its specific situation and, it is hoped, designed to ensure continuity of client servicing.

Retirement Obligations Exist

The importance of sound thought in client division methods cannot be overemphasized because each of the remaining issues is largely dependent on that division. These issues are distribution of staff, disposition of office leases and settlement of buy-out and retirement obligations.

With respect to staff, my remarks concerning clients as chattels apply equally here. This matter is probably not susceptible of solution until a division actually occurs.

Leaseholds and purchase or retirement commitments constitute general partnership obligations in the settlement unless you provide otherwise. Equity would indicate that the division of remaining purchase or retirement obligations should be closely associated with the division of the related clientele, and, if obligations were significant, your agreement should so provide.

Put your agreement out now. Review your dissolution provisions. Does your agreement give a good basic framework for a dissolution? Does it fairly relate to *today's* business? If not, consider revisions and amplifications now without the added burden of aroused emotions—it's a lot easier!

5

Practice Procedures

The Initial Audit Engagement Conference

Bernard M. Valek

One of the basic tenets underlying the generally accepted auditing standards is adequate planning of the audit engagement.

Planning is necessary in order to (1) perform an effective and expeditious audit, (2) identify the type and relative emphasis of the work to be done (including the selection of audit tools to be used), (3) permit efficient scheduling (for both optimum use of available manpower and meeting of client reporting deadlines), and (4) prevent degeneration of staff morale through uneven work loads and inefficient audits. Proper planning also prevents overlooking important phases of the audit, belated recognition of significant problems, last minute rearrangements of staffing, assignments not suited to ability or experience of auditors, and heedless following of prior year audit programs.

This concept of adequate or proper planning pertains to all audits but is particularly important when applied to an initial or "first-time" audit.

This article generally focuses on the planning of the initial audit where the problem potential is high because of substandard accounting procedures and internal control measures.

All auditors and many accountants are familiar with the early preparations for an initial audit. These involve correspondence with the client, the audit engagement letter, and a conference at the client's place of business which usually includes a "plant tour" of sorts. Let us examine this conference and tour of the client's place of business and what should be accomplished during this visit.

This visit should take place *prior* to drafting an engagement letter, which sets forth the conditions affecting the audit, the audit scope and procedures to be performed, and indicates the level of compensation for auditor service. This is important because the auditor should not undertake an examination without first knowing *as much as possible* about the new client.

What should the conference accomplish? Should it consist merely of a verbal interchange between the client and the CPA, a little note-taking and a quick tour of the facilities? Or should it also consist of carefully predetermined procedures designed to give the auditor some basis for establishing the detailed audit procedures to be performed in the audit?

The Need for an Audit Program

A specific set of audit procedures should be implemented at this juncture to test, on a limited basis, the accounting and internal control procedures of the client and to spot possible later audit problem areas. These procedures are particularly important if the auditor suspects the company may have less than adequate accounting and internal control procedures.

Here are some possible procedures that could be used in an upcoming audit engagement.

Analysis of Program Procedures—Model Situation

HELP Company is a small wholesaler with sales of about $10 million.

The president is familiar with accounting but is usually too busy to get involved with the "details," such as reviewing bank reconciliations, general ledger activity, and general journal entries. As a result, the chief accountant, who has had limited accounting education, has free reign over all accounting-related duties. The chief accountant has two clerks working under him, one in charge of accounts receivable, the other in charge of payrolls and inventory-related duties. The company has a handful of salesmen and about 15 other employees, mainly warehouse employees and secretaries. There are vice presidents in charge of sales and purchasing. The company has no perpetual inventory system. All accounting is done manually except for accounts receivable which are handled on a bookkeeping machine.

Because of a request for additional financing, the company's bankers have required audited financial statements. Five years have elapsed since the company's last audit. The president knows of your accounting firm and contacts you to inform you of the situation. You agree to visit the company and discuss the audit with him. But you first ask for some definite evidence as to the condition of the company's records before sending him an engagement letter in which he requests that you give him an estimate of the cost of the audit.

After arrival, you briefly discuss with the president the situation relating to his accounting personnel, accounting procedures, and internal control measures. From this short exchange, you are made aware that problems could exist because of lack of separation of duties and lack of management review of the accounting function.

You then tour the premises and observe that inventory areas are loosely organized and there is no perpetual inventory control. At this point, you have a definite feeling the audit may face potential problems because of poor internal controls, but you are not yet sure. There is more time left to your visit so you set about trying to pin down these problems. What pre-audit procedures can you perform to avoid underestimating the audit fee in your engagement letter and possibly creating a misunderstanding between you and your client?

Journals. Request the journals, e.g., cash receipts, cash disbursements, purchases, sales, and general journal. Review them for careful preparation. Foot and crossfoot one or two months. Review for erasures or changing of figures. Trace a sample of column totals to the general ledger. Review the general journal for unusual entries. If you find no general journal entries, chances are that adjustments and corrections have been made through the other journals or possibly directly to the ledger accounts. Errors or improperly prepared, footed, or posted journals can create many, and expensive, delays in performing the audit.

Ledger. Review general ledger activity for unusual entries such as one-sided "plug" entries or entries with no posting reference. Review the organization of the ledger and ask to see a chart of accounts. Foot a sample of accounts to test clerical accuracy. Trace a sample of account balances to a monthly trial balance or financial statements, if prepared. The lack of prepared monthly or quarterly financial statements may indicate a lack of managerial control and concern about the condition of the business.

Monthly financial statements. If monthly financial statements, or at least trial balances, have been prepared, review them for significant month-to-month variation in operating ratios and balance sheet items. Such early analysis and detection of out-of-the-ordinary transactions or occurrences avoids later surprises during the audit.

Bank reconciliations. Inquire if bank reconciliations have been prepared monthly and are up to date. Foot one or two of them and compare them with the general ledger balance for that month. If the reconciliations have not been prepared, are prepared incorrectly, or don't balance to the books, you may encounter significant problems in the cash-related areas during the audit.

Accounts receivable and accounts payable detail. Inquire if the accounts receivable and accounts payable detail are reconciled with the general ledger each month or periodically. If they are reconciled, ask to see a tape or other type of reconciliation form that is prepared and compare with the general ledger balance. If reconciliations are not prepared, it could mean additional work at year-end involving confirmation work and cutoff testing.

Inventory-taking procedures and inventory summaries. Review client instructions relating to the physical inventory for adequacy. If written instructions have not been prepared, request the client to do so and ask to review them before inventory time draws near. Review the prior year's inventory summaries for adequacy and accuracy, test extend, and foot, on a very limited basis, some sheets. This may spotlight problems related to clerical accuracy. Check the amount of last year's entry to adjust book inventory to physical count. If it is excessively large, it would indicate poor controls over inventory.

Inventory pricing and obsolescence. Discuss with the client the policies and procedures used in valuing the previous ending inventory. Also review the client's policies regarding obsolete or slow-moving inventory items. Be alert for special problems.

Cutoff testing. Discuss with the client's personnel the procedures used in obtaining a proper cutoff in the various areas of accounts receivable and sales, accounts payable and purchases, inventory and cash. If it is apparent these procedures are haphazard and/or deficient, you should urge that they be upgraded for the upcoming year-end.

Fixed assets. Review client depreciation schedules and/or fixed asset inventory cards. Inspect for proper preparation and currentness, and compare with general ledger account balances. Compare them with what you observed during the tour of the premises. This analysis can spotlight idle assets which should be written off or for which a reserve should be set up, and will indicate controls in effect over these assets. Review depreciation rates and methods for possible tax-related difficulties. Recompute a sample of depreciation calculations for accuracy. Check if the client has a capitalization policy. Is it adhered to as indicated by a review of the depreciation schedules?

Federal income taxes. This is a difficult area to discuss in an initial conference, but questions directed at a responsible client official can disclose areas which can add significant time to the proposed audit. A review of the open year's tax returns can spotlight questionable items and their possible effect on audit procedures.

Net worth. Review transactions in capital stock, paid-in-capital, and retained earnings in recent years for possible unusual items.

Minutes and stock record book. These should be reviewed as an alert for possible problem areas and important items such as lawsuits, leases, significant contracts, and contingencies. If they are not up to date, the client should be informed relatively early to update them to help expedite later audit work.

Leases, contracts, and other agreements. Review important lease agreements and contracts for significant features and restrictions that may affect audit procedures to be performed later.

Past audit reports. If the client, as in this case, has had audits in the past, review past audit reports and the latest audit report in particular. Review the opinions for exceptions and the footnotes for significant areas of disclosure, and examine for any other problem areas.

Other Areas

Other common audit areas such as prepaids, petty cash, notes and mortgages payable, and accrued expenses should not be of great concern at this point either because they are immaterial or easily verified by outside parties. Thus, they can be given little or no consideration at this stage.

Significantly, the above cited procedures do not replace the usual test-of-transactions portion of the audit, although, if properly carried out and documented, there is no reason why these procedures cannot reduce the extent of such work to be performed later.

As indicated earlier, this list is not all-inclusive. On a particular audit, there may be other areas of concern, such as investments in subsidiaries, intangibles, unusual types of receivables and payables, and deferred charges and credits which may require review. Only areas of fairly universal concern and applicability are discussed here.

Conclusion

The previously discussed procedures involve only a small time investment but, in some variation and depending on the client, can greatly help the auditor anticipate future problems in the engagement. Three to six man-hours should generally suffice. The audit partner or manager can employ an assistant for some of the more detailed and less difficult early checks.

When these procedures are completed, the CPA has some concrete evidence on which to base an estimate of how much work the audit will involve. This is of particular importance today when a greater number of audits are being conducted on some sort of estimated fee or fixed-fee basis.

By getting problem areas out into the open initially, the auditor can likely reduce or clarify his bill early rather than having to clear up later uncertainties when the audit is in full progress. The client would most likely favor the CPA who investigated and settled potential audit problems early.

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The Audit of the Income Statement

Robert H. Michaelsen

I have always been disturbed by the lack of direct evidence which the "conventional" audit, as now described and performed by most public accounting firms, produces in support of the income statement assertions. The conventional audit relies indirectly on various types of comparative analysis to gather evidence concerning the income statement. Evidence is often not obtained *directly* to support the balances of sales, cost of sales, and several large expense accounts. Personally, I cannot feel comfortable rendering an opinion on an income statement unless I have reviewed and sampled from every material account balance on that statement, in addition to having applied comparative analysis. An explanation of the recommended method follows. The reader should keep in mind that this description is an expression of personal opinion about how the income statement should be audited.

The method suggested retains the review of internal control and those procedures which are ordinarily employed to obtain satisfaction concerning the assertions made in the statement of financial condition. It also retains the comparative analysis which is ordinarily found in the audit of the income statement accounts. The essential difference is found in how the income statement is audited and in how the tests of transactions are made an integral part of the audit of certain financial statement assertions.

The reader should remember that many of the specific procedures described below could be altered somewhat to fit a given audit situation without necessarily affecting the validity of this approach. As a matter of fact, the specifics of this approach may very well have to be altered as a variety of systems and audit trails is encountered. In all cases, of course, the cost of performing a given procedure to a given extent must be offset against the value which this particular effort has in assisting the auditor in reaching the necessary degree of satisfaction concerning the financial statements that he is auditing.

Scanning

The first step in the audit of the income statement is to scan all of the monthly entries to all of the income and expense accounts, assuming that some form of general ledger print-out is available with monthly recap entries for each posting source. If the records are in such a form that scanning is difficult, or if internal control is good, or both, the scanning might be limited to all of the monthly entries to those income and expense accounts with balances which are material in relation to the financial statements.

The auditor should not take any samples from or do any auditing of an account balance unless the balance is material in relation to the financial statements; the account is of such a nature that it is likely to contain errors (repairs & supplies), or important audit information (legal expense); the account has unusual entries; or the account balance has fluctuated greatly compared to prior years. He might also sample from the other income and expense accounts randomly on a limited basis, depending on the degree of internal control.

The auditor would also, of course, need to look at certain income and expense accounts which are closely related to asset and liability balances, but this would be done in connection with the audit of the statement of financial condition, and these accounts could be ignored when he is doing his scanning and sampling. This method of tying the audit of income and expense accounts into the audit of the statement of financial condition should always be used when it is more efficient than scanning and sampling, which it almost always will be with depreciation, insurance, pension expense, and interest expense, for example.

Sampling

After deciding which accounts to sample the auditor must then decide on the nature and extent of his samples. Unless internal control is weak, or unless the size or source of the entries to a given account is inconsistent, he can usually restrict his sampling of the contents of this account to the entries of a given month—either the month with the largest or most unusual entries, or one selected at random. If internal control is weak, or if the monthly entries to a given account are inconsistent as to size or source, the auditor should usually sample from the most material entries for the months with the largest entries. In either case, he should nearly always include material entries which are unusual as to size or source in his selection. If an entry which he selects consists of an accumulation of the results of several transactions, he should scan these and select some of the larger ones for examination. In every case, of course, if problems are discovered, the sample size should be expanded. As an exception to the above, he may sample from the entries for the entire year from accounts that are likely to contain errors, such as repairs and supplies, or even fully analyze an account that contains important audit information, such as legal expense.

The committee on auditing procedure has indicated that it is not in favor of the type of one-month sampling described in the preceding paragraph. I believe, however, that the method of one-month sampling is considerably superior to that conventionally used for two reasons. First, since each (or each material) nominal account is scanned, all months are given consideration and any that look unusual are automatically sampled. Second, since the sample month is picked independently for each account, every month is likely to be included in the sample for at least a few accounts. However, these advantages may still be inadequate for the auditor who wants to have his sample from a given nominal account spread evenly throughout the year.

The approach that I have suggested—that is, from the general ledger account through the audit trail to the transaction—is usually not a practical way to sample from one account for several months, at random or otherwise. It is much less time-consuming to initiate this type of sampling at the transaction level, which is the conventional method for testing transactions.

Does this mean that the approach that I recommend should be abandoned by someone who desires to follow the wishes of the committee on auditing procedure to an extent that is greater than that which is feasible with this approach? I think not. I still believe that the scanning of the nominal accounts and the tracing of unusual entries to satisfactory explanation is a worthwhile, if not necessary, supplement to the conventional tests of transactions in obtaining satisfaction concerning the income statement.

Once his sample is selected, the auditor must still reach a decision concerning how he will audit this sample. Obviously, his evidence-gathering procedures will vary depending upon the nature of the account he is sampling. However, the reader should keep one thing in mind. Nearly all of the income and expense accounts have this common characteristic: their balances consist of accumulations of the results of business transactions. (In this context, a transaction is any event which alters either the nature or amount of financial statement balances.) It is this one common characteristic, the transaction, concerning which audit evidence *must* be gathered if the approach that is being described is to be of any real value. The auditor starts with the general ledger balance and works backward through the system until he reaches the component transactions (general ledger, to monthly entries, to transactions creating them). This is a basic variation of this approach from traditional tests of transactions, which start at the transaction level and work their way to the posting in the general ledger. I believe that the method that I recommend is superior because it starts at the figure which is being audited and samples therefrom. In this way, the auditor is able to see the overall composition of an account's balance and select a sample which includes all exceptional items.

Testing

In most enterprises, there are six basic types of transaction tests which must usually be performed if the auditor is to satisfy himself concerning the propriety of the system's operation. These tests are of cash receipts and disbursements, the voucher register (or equivalent), the general journal (or equivalent), sales and sales returns and allowances, the cost accounting system (if any), and the payroll.

Not all of these tests are adaptable for use in direct support of an income statement assertion. For example, the tests of cash receipts and disbursements, while essential, usually do not involve transactions which are directly connected with the accumulation of income statement balances. The tests of the voucher register and general journal, although they deal with transactions which are directly connected with the income statement, are initiated at the transaction origins rather than at the general ledger. With this approach, these tests will be performed, but will have their origins at the general ledger.

The other three types of tests—sales and sales returns and allowances, cost accounting system, and payroll—can be, and I think should be, tied directly to the audit of the income statement assertions to which they relate.

The tests of sales and sales returns and allowances can be made an integral part of the audit of the sales accounts. First of all, a scan of the sales accounts is made. If internal control is good and there are no material unusual entries, the sampling is restricted to one month selected at random. This month becomes the one for which the conventional tests of sales and sales returns and allowances are performed. If internal control is poor or the entries have unusual variations or sources, testing in more than one month may be necessary.

The tests of the cost accounting system can be made an integral part of the audit of the cost of sales accounts. The procedure would be the same as with audit of the sales accounts, with additional gross profit tests being used to check the reasonableness of recorded costs of sales, both in total and for specific items.

Purchases transactions should also be audited since they make up the cost inputs which eventually become cost of sales. More often than not, these transactions are entered into the inventory accounts. A sample should be taken from the charges to the inventory accounts. This sample of transactions could then be audited by the use of traditional methods.

The tests of the payroll can be made an integral part of the audit of the salaries and wages expense accounts. The procedure would be the same as with the audit of the sales accounts—possibly supplemented with an overall test of matching the total payroll per the payroll tax returns with the total charged to payroll expense accounts, and possibly to inventory.

The audit of the other material income and expense accounts is fairly straightforward. The examination of a sample of transactions should be a sufficient procedure, with the sample ordinarily selected from a single month in the manner that was previously described. In the case where disbursements are charged to an asset or liability account and then transferred to an expense account by monthly journal entries, the sample will obviously have to include items from the account originally charged.

The above comments describe the method of the so-called "Audit of the Income Statement" that I advocate, but one obvious question still remains. How does the auditor determine the exact extent of the procedures which he is going to employ? I think that the use of statistical sampling would be the best approach. After all, what he is doing is taking a sample of the component parts of a balance in order to make an inference about the validity of the whole. What better place is there for the use of statistics? A discussion of the ways that statistical sampling could be applied is beyond the scope of this article.

Conclusion

In the final analysis, the best auditing method is the one which assists the auditor in achieving the degree of satisfaction required by generally accepted auditing standards in the least amount of time; in other words, the most efficient method. It has been my experience that the method I espouse is more efficient than the conventional one, even though it seems to suggest additional procedures, because I feel that I can attain satisfaction on the basis of smaller samples. This is because I can see a more direct relationship between the evidence I am gathering and the financial statements I am auditing.

The logic I am employing in reaching the conclusion that the method I recommend requires smaller samples than the conventional one may be fallacious. Perhaps future auditing research will help to clear up this question and to bring about improvements in method. My hope is that this article will in some way contribute to those improvements.

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Referencing the Audit Report and Financials to the Working Papers

W. R. Ross

CPAs generally agree that the audit report and the accompanying financial statements should receive close scrutiny before release to determine their validity and accuracy. These items are the product of the entire audit effort. Errors, typographical or otherwise, might be considered a reflection upon the quality of the overall work. At best such errors are embarrassing.

Proofing of the final work is often superficial. The words and sentences may be read for coherence, spelling, and meaning, and totals may be verified. But are items in the financial statements checked back to the audit working papers? Do the evidence collected and conclusions reached in the working papers support the type and substance of the audit report to be issued? Are the various captions, account titles, footnotes, parenthetical statements, and the like as explicit as they might be? Affirmative answers to these questions will provide better assurance as to the correctness and readability of the financial statements and, in addition, serve as a double-check on the completeness of the audit working papers.

Of course, the senior staff member on the engagement checks the client-prepared statements. In addition, the statements are subject to review by a manager or partner or both. Likewise, the audit report is generally prepared by the audit senior, concurred in by the manager and signed by a partner. One might therefore conclude that the drafts of the audit report and of the financial statements are correct and that if the final product is in agreement with the draft, further proofing is unnecessary.

It must be kept in mind, however, that, if the CPA is called upon to defend the financial statements on which he has issued a report, it will help his case considerably if the data presented, the inferences made, and the opinions given are adequately supported in the audit working papers. The process of referencing the financial statements and audit report to the working papers can be a significant step toward achieving this goal. In addition, referencing should improve the overall quality of the data and reduce minor oversights and inconsistencies.

Objectives of Referencing

The objectives of referencing are threefold: (1) to disclose any items in the audit report and financial statements which are not in agreement with supporting evidence in the working papers; (2) to disclose items on the financials for which support is lacking in the working papers; and (3) to improve the overall quality and preciseness of the report, associated statements, and working papers.

The person doing the referencing (the referencer) is charged with determining that the data presented in the audit report and financial statements are properly supported in the audit working papers and are in accordance with firm directives, governmental regulations, and professional standards. In addition, he should be alert to possible improvements in layout or content of the report and the financials. While he is not primarily responsible for the working papers in the sense that the senior, manager, or partner is, he should be on guard for incompleteness, especially for questions from reviewers which have not been disposed of adequately.

The Referencing Process

The job of referencer might be assigned to a senior staff member. In addition to the audit working papers, the referencer should be provided with a copy of the audit report and financial statements in their intended final form. In this way he will be referencing the final product and rereferencing can be held to an absolute minimum. Should revisions be required as a result of the referencer's findings, he should reference these revisions once made.

The following is a list of questions about which the referencer will want to be satisfied.

A. The audit files
   1. Do the working papers appear to be carefully assembled and complete?
   2. Has disposition been made of all significant items which were

questioned in writing by a staff member, manager, or partner during the audit?

3. Are all required approvals (e.g., that of the manager or partner) indicated in the audit working papers?
4. Are copies or briefs of important documents and agreements disclosed in the financial statements or auditor's report in either the current year's working papers or the permanent file?
5. Were the draft copies of the report and statements retained for permanent filing as a part of the working papers?

B. The audit report
   1. Is the wording in conformity with firm policy—either that recommended by the AICPA or otherwise?
   2. Does the type of report being issued seem proper in the circumstances?
   3. If a long-form report is being issued—
      a. Are all analyses and comments consistent within the report itself, consistent with accompanying financial statements, and supported, where necessary, in the audit working papers?
      b. Has the clerical accuracy of all computations, footings, and crossfootings been established by some responsible staff person or the referencer and same indicated on the reference copy of the report?
   4. Is the report complete in other respects—i.e., dated, properly addressed, and signed?

C. The financial statements (including related supplementary schedules)
   1. With reference to the general format and overall correctness of the individual statements—
      a. Is the statement balanced on the page?
      b. Does the layout (e.g., indention of captions) promote readability?
      c. Are dollar signs, underscorings, footnote reference style, capitalizations of titles, etc., logically and consistently presented?
      d. Are notes to the financial statements more logically presented on the statements themselves or as a separate list accompanying the financial statements?
      e. Does the statement heading contain the exact official name of the company for which it was prepared, and does the heading properly describe the statement (e.g., Balance Sheet) and indicate the applicable date or period?
      f. If notes to the financial statements are not presented in the body of the financial statements, is there proper notifica-

tion on the statements that the accompanying notes constitute an integral part thereof?

g. Do amounts appear to be stated in their best context (i.e., properly rounded where appropriate)?

h. Has the clerical accuracy of all computations, footings, and crossfootings been established by some responsible staff person or the referencer and same indicated on the reference copy of the statement?

i. Is the information presented consistent within the statement on which it appears and consistent with that in accompanying statements, the related footnotes, the audit report, and other analyses considered a part of the overall package?

2. With reference to individual account titles and related balances—

a. Is the language of the account title in accordance with general usage, free of ambiguities, and adequately descriptive of the item?

b. Are the account title and amount supported in the audit working papers?

c. In instances where two or more account balances were combined and presented as one amount on the statement, is the combination logical and clearly shown in the working papers?

d. Should certain accounts now shown separately be combined and shown under a group caption in the interest of conciseness and readability?

e. Are related disclosures, such as "Inventory, at lower of cost or market" or "Investments (market value $180,000)," properly supported in the audit working papers?

f. Are additional disclosures of the types described in *e* needed to make the statements more meaningful and useful?

3. With reference to the footnotes—

a. Is the footnote readable, adequately comprehensive, and free of ambiguities?

b. Is the wording of the footnote as well as the content supported by documentary or other evidence in the working papers?

c. Is the footnote necessary for adequate disclosure or merely a carry-forward from previous years' statements?

d. Are there matters which are currently not disclosed that should be considered for inclusion?

   - *e.* Is the footnote content consistent with data presented elsewhere in the report and statements, and has the clerical accuracy of all computations, footings, and crossfootings been established by some responsible staff person or the referencer and same indicated on the reference copy?

4. With reference to supporting schedules and supplementary data (in addition to the applicable items listed under C.1. and C.2. above)—
   - *a.* Is the information really useful or should the schedule or analysis be deleted?
   - *b.* Assuming the inclusion of the schedule or analysis to be desirable, could it be presented in a more meaningful fashion than that proposed?
   - *c.* Are there other schedules or analyses which should be considered to improve reader comprehension of the financial affairs of the company?

Other Considerations

In addition to the basic audit working papers, it may be desirable for the referencer to have supplemental material available. For example, if he is referencing a registration statement or other report to be filed with the Securities and Exchange Commission, he should have a copy of Regulation S-X on hand. The accounting firm may have manuals or other materials which will be useful to the referencer in determining that the statements and audit report are in accordance with firm policy and the profession's reporting standards.

Referencer's Responsibility

No attempt should be made by the primary personnel connected with the audit to delegate their responsibilities to the referencer. The role of the referencer is to improve the overall quality of the work, but this is only one part of a team effort.

As evidence that the referencer has checked the financial statements back to the audit working papers, a system of tick marks may be employed. All exceptions, questionable items, or suggestions should be listed. This work will be evidence of the thoroughness with which the referencer has performed his assignment. All exceptions should either be disposed of to the satisfaction of the referencer or he should be absolved of responsibility for the items on which he is overruled. All exceptions or suggestions should be cleared by the referencer himself or by other personnel assigned to the engagement.

Finally, the list of resolved exceptions and suggestions should be bound with the referenced copy of the audit report and financial statements. The questions raised and their disposition should serve as a guide for improving the quality of the working papers and the audit report and financial statements in subsequent years.

Journal of Accountancy, *February 1969*

Applying Statistical Sampling to Small Business Audits

Harry L. Rosengrants

Published studies on the application of statistical sampling have, in general, been related to large company audits. Even those supposedly applicable to audits of small businesses deal with companies having a minimum of approximately $1 million in accounts receivable and about $5 million in sales. Such studies tend to show that auditors are examining too many source documents and that statistical sampling will give an objective basis for making an evaluation of the reliability of the records. Obviously, there is a point of smallness where it might be necessary to perform a detailed examination. However, should not the audits of truly small businesses also have the advantages of the more sophisticated auditing procedures?

Let us assume a small business having only a bookkeeper, the owner, and a shop force of not more than five or six people. Accounts receivable outstanding for any given month could range from $30,000 to $50,000 with annual sales up to $500,000. With this small number of employees, an auditor immediately recognizes weaknesses in internal control arising from the inability to separate duties.

To pursue this example and present one method of applying statistical sampling audit procedures, the following data will be used:

Type of transaction	*Number*
Accounts receivable	75
Inventory items (different types)	2,200
Accounts payable	45
Sales invoices	1,800
Cash receipts	1,200
Cash disbursements other than payroll	900
Cash disbursements—payroll	250

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How Does an Auditor Start?

Assuming this is an initial examination, how—and where—does an auditor start? He cannot evaluate a system and its internal control unless he knows every detail of the way it functions. To learn the operation of an accounting system, the auditor should determine exactly what the system produces. He starts with management and determines how management believes the system operates. By means of a narrative memo or by flowcharts, he makes sketches of the accounting system described by the management. Quite often the system which management believes to be in effect is one that was installed years ago but actually has been changed considerably as bookkeepers have come and gone. Further, the system described may be one that management wishes was in effect.

To provide more information about the system the auditor may become a "sales invoice" and inquire of workers and the bookkeeper how the invoice progresses through the system and the manner in which each operation is performed. With such a description, the auditor may have already discovered differences from the system described by management. He may have also noted what would appear to be glaring internal control weaknesses. At this point he should have developed a feeling about the adequacy of the system. He should record the conflicting duties indicating weaknesses and possible offsetting strong points. He also will have a first impression evaluation of the system of internal control as a whole. At this point he should be able to begin proving the validity of his evaluation.

Which Items Should Be Examined?

The determination of the field of items to be examined is the focal point of statistical sampling. The auditor must know the system well enough to know that each type of transaction will be processed in the same manner and have an equal opportunity to be examined.

In determining there were 75 customers with open receivable balances, the auditor noted that 5 customers carried balances ranging between $5,000 and $25,000. After stratifying the accounts into two groups, positive confirmations should be mailed to all customers with balances in excess of $5,000. Before considering the remaining 70 accounts, he must first determine what will be classified as an error. The misposting of a sales invoice or collection item would be an error if not corrected by the system. However, it would be an acceptable error if the number of such errors were below the acceptance level. One of these errors would require extended auditing procedures to determine how and to what extent it had occurred. Extended auditing procedures would not be applied on a sample basis. The sample will have served its purpose by pointing out the major error.

What Confidence Level and Degree of Precision Should Be Used?

One of the most important audit judgments made in using statistical sampling is that of deciding what confidence level and degree of precision should be used. Each test and each accounting system require an evaluation of internal control and a determination of the significance of the test on the financial statements. If the preliminary evaluation of internal control was of a system with all the requisite strong checks and balances, the auditor should be willing to accept a greater degree of risk and less precision. In the given case, with the weakness being a lack of duty separation, he should not be willing to take a 50-50 chance on assuming that the sample selected is a representative sample.

The auditor decides that he will be satisfied at a 95% confidence level, which means there are 95 chances that the sample is representative against 5 that it is not representative of the field. He will also require that the errors found be within plus or minus 2% of the true percent of error.

At this point of the examination, he must decide if it is practical to use statistical sampling. With only 70 open accounts remaining, it could possibly take more time to determine and select the correct sample size than it would to mail negative confirmations to all of these smaller accounts. The fact that he has decided to use statistical sampling does not preclude the use of audit judgment in order to obtain information in the most efficient manner.

The inventory presents a similar problem. A review of last year's physical inventory shows the total inventory to be $115,000, with approximately 30% of this amount being made up of items with unit costs ranging from $1,000 to $3,000. If the inventory is stratified into two groups—(1) all items with a unit cost in excess of $1,000, and (2) all items with a unit cost less than $1,000—the samples drawn can be used to determine the reasonableness of the total inventory value. Since only approximately 30 items fall into the higher value bracket, all of these should be counted. With only 30 items removed from the total field of 2,200, the field is still 2,200 for all practical purposes. If the auditor determines from the review of last year's inventory that the expected error rate will not be over 2%, he will be satisfied at the 95% confidence level with a plus or minus 2% reliability. He determines, from one of many prepared tables available, that the required sample size is 174.

Before the sample can be drawn he must approach the mechanics of selecting a random sample. In this company's case the selection is rather easy. The client assigns each inventory part a four-digit number. From an Interstate Commerce Commission table of random numbers he can select and list the 174 test items.

What Tests Should Be Performed?

In addition to counting these items, what else should he test? As a minimum, the auditor decides to compare the unit cost with the most recent vendor's invoice, to determine that the unit cost is net of any allowed discounts and to test the inventory extension. While he has the most recent invoice, he will note the date purchased to search for slow-moving or obsolete items.

From the schedule of test items the average of each different part is determined to be $32.26. He can now test the reasonableness of the total inventory valuation.

He counts and costs all items with a unit value over $1,000. These items, when extended, total $45,000. The items under $1,000 in value are extended as 2,170 items @ $32.26 average value, or $70,004. This makes an estimated total inventory of $115,004. The allowable variance, plus or minus 2%, would be $2,300.

With the aid of this measuring device he can determine the reasonableness of the client's stated inventory.

Up to this juncture in the audit the auditor has done very little that is different from an examination without statistical sampling. However, as yet he has not determined the extent to which he can rely on any account balance other than accounts receivable and inventory. The objective and efficient evaluation of internal control will come through the test of recorded transactions. These tests, if performed properly, should satisfy one specific purpose while supporting other areas.

If he specifies that the primary purpose is testing the propriety of cash receipts, the tests he performs should substantiate the reasonableness of accounts receivable as well as cash. When reviewing the system he determined that the owner opened all mail. The owner does not prepare a listing, but, since the number of checks received daily is rather small, he knows the unpaid accounts. The bookkeeper prepares a deposit every other day, and he posts the receipts to the cash receipts journal and the detail accounts receivable ledger. At the end of the month the bookkeeper reconciles the bank account. The owner receives a verbal report of the cash balance during the month and reviews the bank reconciliation. Since the client does not offer cash discounts for timely payment and adequacy of working capital is always a problem, the owner reviews the detail receivable ledger and cash balance with a great deal of concern. All collection procedures are initiated by the owner.

What Auditing Procedures Should Be Employed?

To obtain a feel for the activity and general propriety of the record-keeping, the auditor should review the cash receipts journal and general ledger cash account and satisfy himself as to unusual items. An unusual item could be the receipt of money from the sale of assets or scrap materials. In the cash receipts journal any receipt not arising from normal sales procedures and not set up as a trade receivable would indicate an unusual item, as would any posting in the general ledger cash account not originating in the cash receipts or disbursements journal.

Receipts recorded in the cash receipts journal should be traced to the customers' ledger sheet and, since most customers pay by invoice, the receipt should agree with a specific charge. While investigating this account, the auditor should note whether this account is kept current. If the account is not kept current, a notation should be made on the account receivable listing to aid in determining the reasonableness of the allowance for doubtful accounts. This item of receipt should be traced to an authenticated deposit slip for amount and date deposited. The deposit slip should be footed and the total traced to the bank statement. Since a few sales are cash sales, these receipts should be traced to a cash receipts ticket. As an additional step, certain months of the cash receipts journal should be footed and the postings traced to the general ledger.

What Constitutes an Error?

Now that the auditing procedures have been established, the auditor must decide what will be described as an error and this definition should be documented for his work papers. He has decided to consider an error to be one of the following:

1. Receipt posted to incorrect detail customer sheet.
2. Receipt not paying specific invoices (unless clearly noted as a partial payment).
3. Receipt not posted.
4. Receipt received before charge was set up.

What Are the Mechanics of Selection and Examination?

All that remains on the test of cash receipts is the mechanics of selecting and examining documents. It was determined earlier that there were 1,200 cash receipt items. These receipts were not represented by prenumbered documents and in all probability when the receipts were recorded in the cash receipts journal they were arranged in alphabetical order when the deposit slip was prepared.

The mechanics of selecting a sample and the examination of the test items are just as important as the thought processes used in determining what is to be done. From his review of the system, the auditor believes that the test should be made at the 95% confidence level with a plus or minus 2% reliability. From the sampling table he determines that a sample of 163 test items would be adequate and that at least 3 errors can be expected. If his test reveals that he found 0 to 6 errors, he has drawn a representative sample within his limits.

There are at least two methods of selecting a sample: (1) systematic selection with random starts, or (2) random selection. Since a certain amount of bias could be present because receipts are alphabetized for recording, the auditor decides to use random selection. He knows that the average number of receipts per month is 100, so he can select 163 five-digit numbers from the random numbers table. The two left-hand numbers will be the month and the 3 right-hand numbers the receipt within that month.

The question often arises whether the test items selected should be listed with columns provided to show each test performed and kept in the work papers. As a practical matter it is usually necessary to list the test items because of the physical location of the various files used for the documents examined. If the schedule was worth preparing it should be worth keeping. However, whether the schedule is kept or not, a detailed memo should be prepared setting out the manner in which the sample was selected and the tests performed so that the sample could be reconstructed. This memo must also summarize the results of the test and the auditor's opinion as to the reasonableness of the test and whether it is in conformity with generally accepted accounting principles applied on a basis consistent with the preceding year.

In comparing the statistical test of recorded transactions for cash receipts with what might have been done without this method of selection, the first noticeable difference would be a savings in time required to examine source documents. Without statistical sampling the auditor surely would have selected two or three months' receipts for examination. Had three months' receipts been examined, he would have reviewed approximately 300 cash receipts. This is nearly twice the number examined using sampling methods and his results could only have been that he was satisfied with the three months tested. In addition to testing the whole year he has the reliability of objectively determined mathematical probabilities for evaluation. These are two very important considerations when coupled with sound audit judgment.

The second test in examining the recorded transactions that must be performed is the test of cash disbursements.

In this audit the company has 900 checks for nonpayroll disbursements and 250 payroll checks. Since they have only two employees preparing and checking each disbursement, the auditor should determine whether these two types of transactions can be tested together.

Consideration must also be given to the purchase side of the transactions.

The owner places all purchase orders in one of three ways: (1) salesmen, (2) phone, or (3) letter. Purchase order forms are not used. The bookkeeper receives the vendor's billing invoice and files it until the shop foreman receives the merchandise or service and signs the shipping invoice. The items received are counted and compared to the shipping invoice when received. The bookkeeper compares the shipping invoice with the billing invoice as to quantity received, compares the price to vendor catalogs, or checks price with the owner and tests extension and footing prior to recording the purchase. All invoices are filed alphabetically by payment due date. The bookkeeper prepares the check and submits the invoice and check to the owner for check signature.

Procedures for the payroll require the shop foreman to accumulate the timecards and prepare a weekly time summary. He initials each timecard and signs the summary. The bookkeeper computes the weekly payroll and prepares checks for the owner's signature. With only five employees he can review the payroll summary for propriety before signing the checks.

After reviewing the disbursement procedure, the auditor decides the payroll and nonpayroll disbursements are comparable enough to be included in the same test. What audit procedures should be followed? He decides upon the following audit program:

1. Review the cash disbursements journal and general ledger cash accounts for unusual entries and determine propriety.
2. Foot and crossfoot purchases journal, weekly payroll summary, and cash disbursements journal and trace posting in book of summary entry.
3. Trace canceled checks through cash disbursements journal to supporting documents for amount, payee, and clerical accuracy.
4. Compare date of check to date in disbursements journal and review reasonableness of time required to clear the bank.
5. Test price of items to vendor catalogs and test price-quantity extensions.
6. Review each check for authorizing signature and proper endorsements.
7. For payroll checks, foot timecard, trace to summary sheet, and test computation of gross pay.
8. For payroll checks, verify hourly rate, examine current withholding form, and test computation for each withholding.
9. On all disbursements and source documents, determine propriety of account classification and distribution.

Errors will be defined as any one of the following not corrected by the system:

1. Unreasonable delay between time check was written and when it cleared the bank.
2. Error in price or extension and invoice total.
3. Difference between amount of check and supporting documents.
4. Incorrect account distribution.

Using the same sample requirements as before—i.e., 95% confidence level, expected error rate of 2%, with plus or minus 2% reliability—the sample size is determined to be 162. The selection of the checks to be examined is easier than the selection of cash receipts items, since there is only one series of checks and all checks are prenumbered. For the period of the audit, checks numbered 1186 through 2336 were issued. From the random numbers table and from a random start, the auditor selects 162 four-digit numbers within the range of checks issued.

Upon completion of his test, the result is summarized in memo form. As in the cash receipts test, the main advantages are still a savings in time coupled with a more objective examination.

Applicable auditing procedures and the same methods of selection would be used to choose samples for the test of sales and purchases. The mechanics of selection and examination would be similar; only the thought processes supporting the selection of auditing procedures would differ. Assuming the results of each test were within the acceptable error rates or by extended procedures, the auditor was able to satisfy himself that the samples drawn were representative. What must be done to support his finding?

How Should You Document and Evaluate Your Findings?

The evaluation of internal control constitutes an appraisal of the complete system. One method of preparing an overall evaluation would be to prepare a narrative summary showing the result of each test and a detailed description of the disposition of any errors found. To complete this documentation, the accountant in charge of the field work should make a statement that, based upon the tests performed, in his opinion the accounts are presented in accordance with generally accepted accounting principles applied on a basis consistent with the preceding year.

Testing recorded transactions is not the complete audit but, with additional support of the reconciliation of bank accounts, confirmations, and examination of source documents for investments, indebtedness, and ownership, the CPA can form a professional opinion based on objective methods of evaluation.

The smaller client should have the benefits of the most efficient and professional auditing techniques. The use of statistical sampling should produce a saving in time and a more efficient and professional method of examination.

Year-End Work to Be Done by the Client and Engagement Memo

Paul M. Katz

If this idea is carried out, it should result in substantial time-saving by shifting to the client much routine work that in past years the CPA or his staff had to do.

When the staff member and principal are preparing the time plan and planning the audit program, they fill in the following form. The in-charge accountant numbers those paragraphs which are applicable for the particular engagement. The typist then writes a letter on the firm's letterhead including only the numbered paragraphs, together with any additional comments made by the in-charge accountant. At the same time, the client is given a memorandum of the engagement.

____
(Date)

Dear ________________:

In order for us to be more efficient in the examination of your company for the year ended ________________, we recommend that you provide the following information prior to our beginning the field work.

☐ The general ledger should be in balance and as correct as possible.
☐ Prepare reconciliations for each bank account.
☐ We will furnish bank confirmation forms to be filled in and signed.
☐ Prepare a schedule of accounts receivable—trade, preferably showing how long the accounts have been carried.
☐ We will furnish account receivable confirmations to be filled in and signed.
☐ Prepare a schedule of accounts receivable, officers, and employees.
☐ Prepare a schedule of bad debts written off during the year.

☐ Prepare a schedule of notes receivable. Also, have the notes available for our inspection.
☐ Prepare a schedule of transactions for the period with affiliated enterprises.
☐ Have the original inventory sheets ready for us after pricing and extending have been done.
☐ Prepare an analysis of all transactions affecting marketable securities during the period.
☐ Prepare a schedule of insurance showing the following: policy number, coverage, term, and premium paid. Also, have the policies available for our inspection.
☐ Prepare a schedule of all property and equipment additions and retirements showing cost and, for items sold, sales price.
☐ Prepare a schedule of depreciation.
☐ Prepare a schedule of the life insurance for officers, showing name of officer, insurance company, policy number, date issued, amount of coverage, and annual premium.
☐ Prepare a schedule of accounts payable. Also, save the creditors' regular monthly statements for ____________ where available.
(date)
☐ Prepare a schedule of notes payable showing dates, payee, original balance, audit date balance, amount of periodic installment, rate of interest, and describe security.
☐ Have the corporate stock book and minute book brought up to date and available to us.
☐ Prepare a schedule of all transactions to partners' capital and drawing accounts for the period.
☐ Have a copy of the partnership agreement available to us.
☐ Have a copy of all leases for manufacturing or office space and equipment rental contracts available to us.
☐ Have a copy of any employment contracts with salesmen or executives available to us.
☐ Have a copy of pension/profit-sharing agreement and letter of acceptance from the Treasury Department available to us.
☐ Schedule all repairs in excess of $____________.
☐ Schedule each officer's salary and expense account payments.
☐ Schedule all contributions.
☐ Schedule all taxes paid.
☐ Schedule all professional fees.

We understand that we are to make an examination of the financial statements of ____________ as of ____________ and to express our opinion on the statements. The examination is to be conducted in accordance with generally accepted auditing standards and will include such tests of the accounting records and such other auditing procedures as we may consider necessary. It is not contemplated that we shall make a detailed examination of all transactions, such as would be necessary to disclose any defalcations or irregularities which may have occurred.

Our charges for this examination will be at our usual per diem rates, plus any direct out-of-pocket expenses that we incur.

We will inform you immediately of any auditing problems we encounter. Any suggestions for improving the internal control or other items which we believe feasible will be directed to your attention at the conclusion of the engagement.

Please call on us for any questions you have regarding the items mentioned in this letter.

Very truly yours,

____

(Partner)

Journal of Accountancy, *June 1974*

How Small Firm Practitioners Can Avoid Substandard Audits

Thomas D. Wood

From a pragmatic viewpoint, small firm practitioners may well expect further increases in their liability insurance premiums. Perhaps the most serious consequence will be the increasing scrutiny given statements of financially troubled companies audited by small firm practitioners, when third parties and third-party beneficiaries incur losses. The possibility of lawsuits in these instances widens as decisions and judgments are handed down, as interpretations are expanded, and as further gaps appear in what are now considered acceptable auditing standards. All this points to the backwash becoming the anathema of small firm practitioners.

The admonition to "dot every 'i' and cross every 't'" has little, if any, operational import for the small firm practitioner. Rather, he or she should carefully analyze areas where technical errors can occur, review circumstances contributing to a possible breakdown in the audit procedure leading to an inappropriate opinion, and consider advice on how to avoid both. This article intends to offer such advice to the small firm practitioner.

There are at least five factors, each of which can adversely affect the care given an audit and consequently its quality: the timing of the audit, the fee agreed upon, the technique of the audit, the client, and the practitioner.

Timing

There are two aspects to the timing problem. One is the date as of which the audit is performed. The other is the time span over which the audit proceeds. Although these are overlapping, they are separable.

Audits with fiscal years ending between November 30 and January 31, that is, those on which the preponderance of the work must be performed during the filing season for individual income tax returns, place excessive strain on many small firms. The strain is felt through pressure from audit clients to complete the audit within a reasonable time after the close of the year, coupled with the time constraint of the filing deadline. Practitioners and staff must work long hours or hire part-time assistants or both. Either alternative enhances opportunities for errors affecting audit and tax work. Judgment decisions are likely to be made more quickly and perhaps without adequate consideration of possible consequences.

Postponing such decisions until more pressing work is completed has the effect of extending the audit over a longer time. This has several possible adverse effects on the quality and usefulness of the audit. Any predetermined time budget will probably be exceeded as audit work is postponed. Memory of work previously completed must be refreshed with obvious loss of time and impairment of efficiency. Moreover, the further removed from its closing date an audit is released, the less value the report has to management and other users. This also bears adversely on the auditor's reputation.

There is no easy solution to the timing problem, but planning is the first step in avoiding hasty judgments. Small firm practitioners should take full advantage of slack periods to perform many auditing procedures usually saved for the 60 days following the balance sheet date. Following is an abbreviated list of procedures that can be accomplished at any time of the audit year: review of board meeting minutes and correspondence files, vouching, assessment of internal control, footing journal columns, tracing postings, counting petty cash, reconciling bank accounts, receivables confirmation and analysis of such accounts as plant and equipment and expenses from the date of the last audit to the date of the interim work.

A conscientious and persistent approach to this interim work can reduce post-year-end tasks by nearly 50 percent. Using a time budget, a calendar, and an audit program, the auditor can identify various procedures for each audit by day or week within slack time. It is conceivable, for example, to confirm accounts receivable for all calendar year audit clients in the month of June. July and August may be reserved for certain specified other procedures for each client. This approach will probably promote efficiency for the auditor. Moreover, it may appeal to the client from several viewpoints. First, the client may approve of the avoidance of an eleventh hour rush when the auditor is present continuously (or seemingly so) for several weeks. Second, the client may appreciate progress billings spread throughout the year rather than one large one. Finally, and this will benefit the auditor as well, the client may take advantage of a more relaxed relationship with the auditor by seeking advice on management advisory services and tax planning matters.

The Audit Fee

Undoubtedly, this is a sensitive area for small firm practitioners, but the quality of the audit work may be affected by a substandard fee. This is not to indicate that an auditor would purposely omit a required procedure because of a low fee or that CPAs are motivated solely by financial reward. The tendency to do what is considered the minimum necessary rather than what might be thought of as optimal must be avoided. Thus, confidence levels, for example, may be revised downward leading to a smaller sample size. Working papers may be abbreviated, combined, or even eliminated. Review time may be minimized. In short, given economic realities, the audit is likely to be condensed to minimum levels with a corresponding increase in the risk assumed, albeit unwittingly, by the auditor.

Small firm practitioners rationalize low fees on several grounds. First, in instances where the practitioner does the complete audit, the reasoning is that partner or even senior rates cannot be charged for junior level work. This results in a low average rate. Alternatively, a junior may be assigned the major portion of the audit. The result is either that the work must be checked so closely that substantial time is wasted, or that much of the work must be done a second time with obvious implications for the ultimate fee.

Practitioners should satisfy themselves that they are getting an adequate and representative fee. Of course, only the practitioner can determine what is adequate. However, as has been suggested, practitioners often compute an audit fee on the basis of an average fee for junior, senior, and partner level work, all performed by the practitioner, and, as a consequence, they get a smaller hourly rate than that achieved for other types of services. A representative fee is one that is comparable both to fees for other services performed by the practitioner and to fees charged by larger accounting firms for the same services. Research in fee structure, assuming the information would be divulged, may support the contention that regional and national accounting firms get from 125 percent to 200 percent more in fees for an identical audit than the small firm practitioner but, at the same time, get about the same fees for equivalent tax and other services. In other words, large firms may value their audit services more highly than small firm practitioners.

The Technique of the Audit

In audit work, familiarity and repetition can lead to serious consequences. When an audit has been performed previously, perhaps for several years, use of formalized audit programs and internal control questionnaires tends to become lax or possibly abandoned completely. Often the rationale is that the auditor can avoid the routine either because he or she has what is believed to be intimate knowledge of the client's system and operation or because he or she has performed these in previous years without once uncovering an exception to sound procedure.

No matter how experienced the auditor, omission of part of an audit program, whatever the reasoning, can result in overlooked audit procedures, and the results may be crucial to forming an opinion. Laxity in using audit programs not only may cause a loss of control over the audit, it may affect scheduling and thus cause unnecessary delays.

Failure to complete an internal control questionnaire (or, alternatively, to flowchart the system or to write a description of it) may have serious implications. First, the auditor has no working paper to support the contention that he or she reviewed or evaluated the internal control system. Second, systems evaluated as "strong" in a prior year can break down in a matter of months or even weeks with a change in personnel or for other causes not readily ascertainable. Thus, the fact that the previous year's audit (and the several prior to that) contains a satisfactorily completed questionnaire is not a guarantee that the system continues to function properly. In the place of a formal internal control questionnaire, the small firm auditor must be careful not to substitute "auditor's intuition" or a few rules of thumb coupled with limited tests to establish that certain internal control "principles," e.g., separation of cash handling from recordkeeping, are being followed.

One audit technique often overlooked by the small firm practitioner is an audit time budget. Time budgets afford several benefits, chief among which is the requirement that the auditor plan the audit in order to develop the time budget. Additionally, time budgets are useful as a basis for estimating fees, allotting staff personnel, allocating the practitioner's own time, and as a standard for measuring the quality of the audit work.

Failure to plan the audit, whether by means of a fairly detailed time budget or not, can lead to possible omission of needed procedures and inefficiency or duplication of work. Overzealous staff personnel may take shortcuts, thereby failing to uncover an error. In statistical or judgment sampling every transaction selected from the universe must be scrupulously examined, or the auditor falls into the trap of sampling the sample.

Working papers serve as (1) convincing evidence that procedures were performed, and (2) the sole indicator of the extent to which the work accomplished led to the forming of the opinion. The second of these functions shows how dependent the auditor is on the working papers. The completed file of working papers, properly combined, is a series of interdependent and sequential steps necessary to the auditor's judgment. Moreover, and especially important for the small firm practitioner, the working papers support that judgment under scrutiny of others who may be critical of the auditor's opinion.

The importance of working papers, as described above, is stressed to illustrate the possible consequences of omitting certain working papers, preparing them in cursory fashion, or leaving them incomplete. Essentially, every account in the ledger should have an audit working paper supporting it. Some accounts, such as cash, inventory, or accounts payable, may have several. Certain accounts, especially income and expense accounts or fixed asset accounts, may be combined on a single working paper. Of course, the working paper file is not limited to those directly supporting accounts in the ledger. Internal control questionnaires, audit programs, and abstracts of minutes of directors' meetings, to name only a few, are "working papers."

Every annual audit should be treated as a new one. The auditor should neither take anything for granted nor make bold assumptions. This should not be taken to mean that redundancy is required; quite the contrary. It means simply that the auditor should prepare and use an audit program for each audit, relying on his experience with this firm where appropriate. He or she should review internal control each year and complete a questionnaire, noting where procedures and policies have changed and assessing the effect of the change. Where assumptions are necessary because of circumstances, a list of them should be made and placed in the working papers. A conscious, overt effort should be made to gather evidence in support of each assumption. At the close of the field work the practitioner should pause to review the evidence collected and form an opinion based on that evidence independent of his opinion and the grounds for it in previous years. Thus, each year's audit is made to stand on its own merit, and the opinion is not prejudiced by last year's result.

Each audit should be performed as if it, the resulting opinion, and the working papers supporting the opinion were to be critically scrutinized by other experienced CPAs. Every working paper should be complete, explanatory, and accurate. Difficult judgment decisions should be written down along with all factors taken into account in arriving at the final determination. The auditor should carefully note exceptions, in writing, especially exceptions to the materiality principle. Reasons why an exception is or is not considered material should be listed in the working papers. The effect of immaterial items should be assessed in the aggregate to ascertain that the total is also immaterial. Finally, the practitioner should be aware that conservatism is an important ally in defense of an audit opinion. Very few audits have found their way to the courts because of an *understatement* of assets, equity, or income.

The Client

The ownership, size, and complexity of the client can affect the quality of the audit. There are three circumstances in which the auditor must exercise special care.

One-person businesses and those operated by a family pose control problems which must be guarded against. In addition, the auditor must be watchful of becoming complacent when auditing family enterprises. In one-person businesses, and to a lesser extent in those owned and run by members of a family, one person controls cash, collections, and disbursements, records entries in journals and ledgers, and receives and records inventory acquisitions. Thus, there is virtually no internal control. Cash handling and recordkeeping are not separated, and one individual handles transactions from beginning to end. In the family business, particularly, the auditor must overcome any tendency not to investigate controls carefully because of a preexisting bias that the family will not attempt to defraud one another or the taxing authorities by kiting, lapping, or other devices to misappropriate assets. In other words, the auditor must not assume prima facie that because an owner-shareholder-manager is operating the cash drawer the cash is properly received and recorded.

Audits of large firms are often more complex than those of smaller firms. If complexity is not a deterrent, the sheer magnitude of an audit of a large company will be disquieting. Some complications with which the auditor may not have experience are (1) acquisition of subsidiary companies and the necessity of certifying consolidated financial statements (this is especially true where the subsidiaries are dissimilar in structure and operation from the parent); (2) undertaking, by the client firm, a large government contract; and (3) opening or acquiring a foreign operation.

Some audit clients outgrow their auditors and may pose logistics problems for the practitioner. This is not to suggest that the practitioner should not attempt to grow; indeed he or she should. Rather, the practitioner should take a realistic and critical view of keeping or taking on an audit of a firm sufficiently large to stretch the capabilities of the practitioner's full-time staff.

Audits of financial statements of clients with fairly sophisticated in-house automated accounting systems and computerized information systems require a special expertise that small firm practitioners are not likely to have. The equity funding matter will undoubtedly become a signal example of imaginative computer programing and operation designed to "beat" the auditors. Any computerized operation has identical capabilities, even if on a more modest scale. The complications which the auditor may encounter are several. One is the possible use of one of the more recently developed computer "languages." Another complication is constant advances (and consequent changes) in both hard- and software components. Of particular concern is a new computer installation where "debugging" has not been completed or where computer personnel are not fully trained to use the equipment. Changes in key computer personnel can result in problems affecting the reliability of output data.

Small firm practitioners should avoid taking on audit clients that are too large or too complex; rather, they should refer them to other accounting firms. Moreover, the practitioner should reevaluate present audit clientele for possible referral for either of the reasons mentioned. Audit clients that consume a disproportionate amount of time in the year's busy season should be considered for divestiture. Often, unsuitable audit clients are accepted out of an obligation to the referrer or out of fear that other referrals will be lost. This is faulty reasoning. There is no stigma attached to an honest refusal to take on a client on the grounds stated. In fact, the CPA will probably enhance his reputation with a "no" that is tactfully worded.

The Practitioner

Finally, the practitioner himself can affect the quality of the audit. Sole practitioners and those with one staff accountant are most susceptible to being under constant client pressure. They are likely to be working far more than a normal work week. On audits they often perform junior, senior, and manager level work. Moreover, audits are likely to be interrupted to the point that the audit is done in a series of disjointed time intervals of two or three days in sequence with equal amounts of time alternately spent on other projects.

With time a severe constraint, the practitioner feels unable to accomplish the technical reading or to attend the professional meetings needed to keep current on developments, such as pronouncements of the Financial Accounting Standards Board, statements on auditing standards, and the myriad of other technical pronouncements released regularly.

Sole practitioners and firms with only one principal should develop rapport with other practitioners. As confidence in his or her technical ability grows, the practitioner should select one or more of the other practitioners with whom to discuss problems of a technical nature. Such an informal relationship will be mutually beneficial. Difficult judgmental issues can be aired. The opinion of another professional can be weighed against the practitioner's own. Reasons for divergent opinions should be investigated. This is not to suggest that the practitioner can or should pass responsibility for a difficult decision; however, there are persuasive reasons for hearing other viewpoints. Alternatively, where opinions concur, the practitioner can feel more secure in his or her own judgment. This is especially true of relatively inexperienced practitioners or of those lacking expertise in a particular instance. Older, experienced professionals should indicate a willingness for this kind of relationship.

The auditor's opinion is the result of an informed judgment, based on the evidence, made by bringing to bear experience and an understanding of the theory of auditing. While experience is cumulative and is enriched with practice, the knowledge of theory can diminish as the practitioner becomes further removed, in time, from textbooks. Consequently, he or she should diligently read current technical literature and pronouncements of the American Institute of CPAs. The reading should be done with great care and attention to detail. The practitioner should read with an open mind. This does not mean that he or she cannot or should not make his or her own critique, but that he or she should primarily read to learn.

This article has attempted to provide a perspective for a small firm practitioner, in light of court decisions, through which he or she can reconsider factors which can adversely affect the audit. Moreover, an effort was made to offer suggestions to avoid some of these circumstances. It does not seem likely that any set of prescribed rules or procedures will assure the practitioner of avoiding the necessity for possible legal defense of an audit. In fact, such a list, even if possible, may be undesirable. However, practitioners should consider every reasonable means of avoiding the embarrassment of legal proceedings while continuing to render invaluable services to their clients and society.

Journal of Accountancy, *September 1968*

Public Controllership

Robert K. Whipple

Our firm does not perform any accounting services that are different from those performed by other local practitioners around the country. However, our philosophy of public accounting and our approach are different from most and I would like to share them with you.

To understand the results of our change in approach to public practice, you should have some background on our firm. The firm in 1959 was composed of four people: a sole practitioner, a young business school graduate, a bookkeeper, and a secretary/office person. Approximately 90 percent of the work was write-up and tax practice. The gross fees were approximately $51,000 at an average firm rate of about $8 per hour (total billings divided by productive hours).

During the next four years we conducted the same basic type of practice with some upgrading of fees and services performed, but we still undertook almost any type of work requested. At the end of 1963 the firm was still made up of four people: two CPAs, a bookkeeper and a secretary/office person. The fees had grown at the rate of 5 percent per year to approximately $61,000.

It was during the 1963–64 period that we began gradually to change our thinking about a public practice and how we wanted to make a living. This was not done abruptly but in bits and pieces. Only after we set some firm objectives were we able to start making the decisions that have led us to our present status.

We are now a firm of three CPA partners, three CPA staff, a secretary/office person and one part-time bookkeeper. Our fees for the past 12 months were in excess of $185,000 at an average firm rate of over $19 per hour. This is a compounded growth rate of approximately 40 percent per year since 1963 compared to the 5 percent per year growth for the period 1960–1963. All of this growth came from existing and new clients. None came from merging or acquiring other accounting practices. Now we have virtually no write-up work and our tax practice accounts for less than 20 percent of our gross fees.

I would like to tell you about our firm's objectives and the type of practice we have developed. During the 1963–64 period we observed a need in our small- and medium-sized clients for what we call a "public controller." These clients need an experienced accountant to come in periodically on a fee basis to provide the controller/financial management function for the business. These companies could not afford or did not want to have a full-time trained accountant on their payrolls. We are fulfilling their need for a controller-treasurer on a part-time basis and have become part of their management team. We participate in the financial and accounting decision-making of these companies. Many of our activities lead us into the creation, review, or supervision of an accounting system, of budgeting, forecasting, cost analysis, alternative choices, internal controls, internal auditing, and tax planning, and we also act as a sounding board to management for other areas of their business. This is a continuing service rather than the one-shot engagement typically found in most management services work.

As previously mentioned, most practitioners engage in these activities to some degree just as we did in the earlier years. Upon analysis, we discovered that for most of our write-up and tax clients we were charging for the financial statements and tax returns but giving them the consultation free. We found that our firm was selling a "product"—a financial statement, a tax return, etc.—and our clients felt that these consulting services were included in the price of the "product." In most cases our work ended with the transfer of the "product" as our staff was structured and motivated to "get it out."

Through introspection and discussions we began to change our thinking. We realized we were neither utilizing all our capabilities nor fulfilling our clients' needs. Now we are selling intangibles: advice, technical knowledge, planning, etc.

This change in philosophy is similar to the difference between a doctor's selling health and a drug store's selling prescriptions. Our firm is in the business of selling "business health." Any product (financial statement/tax return, etc.) now is the beginning of a business health program; the product is incidental to our major activities with a client.

We feel the advantages of this philosophy of public accounting are many. It provides our people with stimulating and challenging work. It commands higher fees than most other accounting services. We have found that we are putting in less time with the work spread more evenly throughout the year. We need less clerical help and have smaller overhead than most firms of comparable size. We do not feel that we are vulnerable to the technological changes being brought about by the computer. We are not caught in the developing dilemma of performing auditing and management services for the same client since we do not provide audited financial statements to anyone whom we are servicing as "public controller."

In conclusion, I would like to pass on several things we have learned in developing this type of practice.

You must be selective. Don't accept every client with whom you come in contact. In our firm we look for three things in a prospective client:

1. The desire for us to provide the type of service described above.
2. The financial ability to pay for the service.
3. Congeniality of personality coupled with challenging business operations.

Don't be hesitant to fire a client—cull out the deadwood. If a client doesn't meet the above criteria, you are better off without him. You don't do your best work for a client you'd rather not have. Besides, we have found that our policy has a beneficial effect upon our staff morale and on the outside centers of influence from which we obtain new clients.

You must keep up on technical knowledge because of the heavy emphasis on consultation. We have relied heavily upon the American Institute of CPAs and the state society and their professional development programs. Everyone in our firm from partners to the newest staff is required to attend at least one professional development program each year. We encourage and pay for attendance at all professional activities.

You must know the value of the services you are rendering. Reliance upon hourly rates can be a pitfall. Contribution to "business health" must be a factor in all billing.

You must develop a professional attitude in your staff. We have no place in our firm for accounting clerks or career staff people.

Don't overextend yourself or your staff. You must have time available to service the needs of the client. Time pressures result in substandard work.

Do what you can do best and farm out the rest. We have several clients that we share with other practitioners. We provide "public controllership" and they provide the attest function. We have found that in most cases our fees for a year exceed those for the audit.

I hope that these comments on our approach to public accounting may be of some benefit when you formulate your objectives.

Journal of Accountancy, *October 1977*

An In-House CPE Program

Martin Cass and Norman Kronstadt

Our firm, which consists of 35 professionals, including 6 partners, has developed and conducted a quality in-house continuing professional education program for the past five years. In 1974, the program was expanded to meet Florida's CPE requirements. We thought we would share our firm's experience.

Our main goal is to achieve a worthwhile educational program for all personnel that will expose them to as many areas as possible. This exposure enables us to recognize opportunities and problems encountered by our clients, expand professional competence, and maintain an awareness of recent developments in the profession. By accomplishing our goal, we feel service to our clients will be improved.

The program utilizes the seminar-discussion method of presentation. The entire staff is required to attend. Local sole-practitioner CPAs and attorneys are invited to attend our seminars free of charge. The number of outside guests varies, depending upon the topic. On the average, six to eight invited guests, mostly CPAs, attend. When a tax program is presented, attendance by attorneys is greater. For example, six tax attorneys attended a seminar on tax fraud. We find the interaction during the seminars among partners, managers, staff, and invited guests heightens the learning experience.

Our continuing education committee, comprised of two managers, selects the subject areas. These areas cover the range of services we provide our clients, namely, accounting, auditing, taxes, management advisory services, as well as areas of personal and practice development. The particular subjects are selected according to the needs of the clients and staff. Some seminars concentrate on one particular area, e.g., unaudited financial statements—whereas others will be a mixture, e.g.,

Exhibit 1

Continuing professional education program—1976 schedule

Income tax return preparation for 1976	(IHL)	2 hours
Tax fraud and the intelligence division of the Internal Revenue Service	(GL)	4 hours
Tax Reform Act of 1976	(IHL)	3 hours
Planning for the retention and disposal of business interests at death	(GL)	4 hours
ERISA—An update	(GL)	4 hours
Computers for accountants and auditors	(GL)	4 hours
*Review of current accounting pronouncements	(IHL)	9 hours

IHL—In-house lecturer
GL—Guest lecturer
* Held in two evening sessions

new FASB statements, revenue rulings, etc. As a sample of the topics covered, a schedule of the firm's 1976 program is shown in Exhibit 1.

Once the subjects are selected, the next step is to engage a discussion leader. We have found a variety of sources from which to select discussion leaders and lecturers. We seek individuals with special expertise from within as well as from outside our firm. Since the project's inception, approximately half of our programs have been conducted by members of our firm.

A number of local attorneys have participated as discussion leaders. They were pleased to speak at such a gathering and indicated they would be available if called upon again. We also have found other CPAs, actuaries, teachers, and specialists eager to present programs. A national CPA firm with whom we have had a working relationship presented a seminar on auditing standards utilizing programmed texts and workbooks. Industry and government also have provided us with subject matter and lecturers. For example, specialists from IBM presented a program on computers and their relationship to accounting and auditing. A special agent from the Internal Revenue Service presented a program on tax fraud and the workings of the intelligence division.

For added interest, several discussion leaders have developed case problems for the seminars. We have also employed audiovisual aids—overhead projectors, video tape players, and film strips—to enhance the discussions.

The seminars are held in local bank and hotel meeting rooms from May through January in the early evening (5:00–9:00 P.M.) and do not conflict with client work. The cost of our program is minimal. Most of the outside speakers and meeting rooms have been made available to us free of charge. Staff members prepare for and attend the seminars on their own time. The basic cost covers the dinner and refreshments at the seminars.

Overall, we find our program has successfully met our goals. The quality of service to our clients has measurably improved. We have developed new areas of expertise within the firm and we have widened our relationships with other community professionals (both as a source of new business and of broader knowledge).

We think that it is difficult for a local accounting firm to provide a complete CPE program by itself, but we have discovered in our community a great deal of cooperation among businesses, industry, and government and a willingness and enthusiasm on their part to support our programs. We believe that all those involved reap the benefits.

Have You Made Your Estate Plans?

This article by the estate tax planning section of the taxation committee of the Illinois Society of CPAs has been adapted slightly.

The adage about the shoemaker's children applies equally well to CPAs. Many of us have done considerable estate planning for others, but relatively few of us have completed our own estate plans. The problem is that many CPAs think they are too busy serving their clients to worry about themselves.

This brief review should provide useful suggestions for CPAs who have already undertaken the planning of their own estates, and will serve as a starting point for the many who have not yet faced their estate planning problems. It is not intended as a complete or in-depth discussion of all your estate planning needs, but it will highlight some problem areas of which CPAs should be most aware.

The CPA Practice as an Asset of the Estate

The practice represents a unique asset in the estate of a CPA, regardless of the form of ownership, i.e., sole practitioner, partnership, or professional corporation. How to solve the problems of valuation and disposition of this asset will vary depending on the type of ownership involved; as a matter of fact, just changing from one form of ownership to another form can have substantial estate planning impact.

Many practitioners are faced with the question of how to arrange matters so that their practices can be continued after they die. It is sad to contemplate that the practice one has worked most of one's life to build, and which often represents a substantial asset in the CPA's estate, may be liquidated at only a fraction of its real worth. Planning for the CPA's estate can avoid this result.

A number of alternatives are available to provide for the continuation of one's practice, improving the probability that the estate will realize its true value. Among these is a merger which would take place before death and which could be effected with another sole practitioner, a partnership, or a professional corporation. An obvious alternative is to bring someone into the practice who will be able to assume the responsibility for continuing it.

A third possibility is the "buy-sell" arrangement. Such arrangements are common in partnerships and multimember professional corporations. It is interesting to note that such arrangements are available for use between a sole practitioner and his employees, between two sole practitioners, between professional corporations, or between any combination of persons or entities.

Mergers and buy-sell arrangements will provide the estate with the means for greater liquidity, and an arrangement of this type can also minimize problems of valuations by establishing an estate tax value for the practice.

All practitioners should keep accurate and complete records to ensure that the executor will be able to have the work-in-process at time of death completed and be in a position to collect for any unbilled time. Failure to keep adequate and up-to-date records will cause these assets to be lost to the CPA's estate.

Protecting the Practice During Life

Of prime importance in the matter of estate planning for CPAs is the consideration of protecting and preserving the practice during life. Prudent management will help to ensure the existence of a valuable asset at death. Adequate malpractice and other insurance can prevent diminution of the estate through losses or claims. Likewise, retention of qualified personnel, who may represent the most important assets of a well-organized firm, will enhance the value of the practice. Suggestions in this area include the adoption of benefit plans and delegation of responsibility and authority to employees or associates.

Considerations in Disposing of the Practice

In disposing of the practice, the CPA will be faced with two major problems. First, what is the proper value for the practice? Second, how can availability of funds be insured?

Valuation Problems

The problem of valuation is common to the sole practitioner, partnership, and corporate forms of operation. In each situation, consideration must be given to accounts receivable and payable, unbilled receivables, work-in-process, and book value as contrasted with market value of assets and goodwill or going-concern value. In Illinois, failure of a professional corporation to establish a value for stock to be purchased at death brings into effect the statutory buy-sell arrangement based upon book value only. For a cash basis firm, the extent of the problem created is obvious. In most instances, it should be sufficient if records are maintained on a current basis in such a manner that they may be easily converted to the accrual basis. In addition, periodic review and revaluation of work-in-process and total equity is important. Failure to consider the proper elements of valuation in a particular firm and whether the valuation, as fixed by agreement or formula, properly reflects economic reality can be costly.

Tax Considerations

Having established a planned valuation of the interest, attention should be given to the tax consequences of disposal. In a professional corporation, sale of the corporate stock to other shareholders results in a currently nondeductible basis for them in the acquired interest; redemption by the company provides treasury stock for later sale to others.

In partnerships, the considerations are more complex. The members of the partnership can agree that payments will be made by the partnership in liquidation of the partner's interest. Such payments can be tax deductible by the remaining partners to the extent they are for the outgoing partner's interest in previously unrecognized partnership income. This treatment is also accorded payments for partnership goodwill, if that designation is not specifically indicated in the partnership agreement. On the other hand, if the remaining partners individually purchase the interest, the payments would not be deductible. This result can be mitigated to some extent with a special election which would at least allow the purchasing partners to recover their cost in the outgoing partner's share of previously unrecognized income as the amounts are collected. Either choice will result in ordinary income for the outgoing partner or his estate or other beneficiary, to the extent that the payments represent his share of previously unrecognized income. Even the portion of the amounts which represent payments for goodwill will be ordinary income if they are paid by the partnership, unless the partnership agreement designates the amounts as for goodwill or if the remaining partners individually buy the interest of the outgoing partner.

The partnership can agree as to the time for closing the taxable year with respect to a deceased partner. The year may be closed on the date of death or remain open until the regular fiscal year ends. If the year closes at the date of death, the income of the deceased partner is reported in his final income tax return, to be offset by his personal deductions. If the year remains open, the income will flow into the estate's or beneficiary's income tax return. The final distributive share is treated as "income in respect of a decedent." Likewise, collection of receivables by the estate or beneficiary of a sole practitioner or a partner whose business was on the cash basis of accounting will constitute income in respect of a decedent.

The sale of an individual proprietor's accounting practice will be fragmented by the Internal Revenue Service into a sale of each individual asset with income tax consequences determined accordingly.

Funding Problems

Two methods of providing funds for the disposition of the practice are (1) life insurance, and (2) immediate or deferred cash payment arrangements. The health of the parties and availability of funds may determine the appropriate choice. In a partnership, the effect of funding with life insurance paid for as a firm expense requires each partner to share the cost of all premiums in his partnership ratio. Under a cross-purchase arrangement, the partner may incur a higher or lower premium cost than his share based on his partnership ratio. A deferred payment arrangement permits the purchase to be made out of subsequent earnings, perhaps from the savings generated by replacement of the decedent with an employee whose compensation is lower. The purchase price may even be contingent upon the fees or earnings. Obviously, an arrangement may be split-funded with both insurance and deferred payments.

Professional Society Benefits

Some state societies maintain an emergency assistance plan for providing assistance to disabled participants or to the estate of a deceased participant where the member has specifically designated a practitioner or firm for the disposition of his practice to be contacted by the society at his death. You should check with your state society to see what type of program is available to you.

The American Institute of CPAs and some state societies offer various insurance plans which can be used in estate planning. For example, group-term life insurance can be assigned to reduce the estate or fund a buy-sell agreement.

Lifetime Planning Techniques

The CPA can maximize the size of his estate by taking advantage of the same tax planning techniques which he already offers his professional clientele.

Change in Form of Ownership of Practice

It may be desirable for a CPA to change his present sole practitioner status to that of either a professional corporation or a partnership which can provide certain guaranteed payments as retirement benefits. Establishing such an entity may create continuity for the practice so that clients may wish to remain with the firm after the practitioner's death, thereby producing more income or a better selling price for his heirs. The CPA should realize, however, that a transfer of receivables and payables to the new entity at formation may produce tax problems. These problems can probably be avoided by having the sole practitioner collect and pay these amounts himself.

The CPA should investigate the availability of a fiscal year (other than the calendar year) for his new entity, both for deferral of income tax and to coincide with his natural business year.

HR 10 (Keogh) Plan

A tool to build the estate of a sole practitioner or the members of a partnership is an HR 10 (Keogh) plan. This allows self-employed individuals to set aside 15 percent of their earned income annually (to a maximum of $7,500 a year). Thus, income can escape current taxation, the amounts so set aside can grow through tax-free compounding of returns on the investment thereof, and taxes can be paid on the total distribution under liberal income-spreading rules at retirement.

Professional Corporation

The professional corporation has several potential advantages. Under present law, pension or profit-sharing benefits can be more liberal than under the HR 10 plan. The CPA's interest in the practice may be more readily valued and transferred. A sale at a profit can be treated as a capital gain while Section 1244 may offer an ordinary deduction in the event of loss. Other advantages available to the incorporated CPA include tax-free group-term life insurance coverage up to $50,000, tax-free medical, dental, and disability income benefits and the opportunity for a $5,000 death benefit to the CPA's spouse, deductible by the corporation but tax free to the recipient.

There are possible problems with incorporation, such as exposure to double taxation of income and questions as to the reasonableness of compensation and accumulated earnings, as well as legal costs, statutory fees, and required reports.

The entire subject of a professional corporation for a CPA must be carefully studied with particular emphasis on ethical considerations. Legal requirements should be carefully followed and the official pronouncements of the American Institute of CPAs and your state society of CPAs must be considered.

Frequently a unilateral decision by a partner is made to adjust a standard billing to client and this adjustment should be allocated to personnel responsible for it or allocated to an appropriate administrative classification where the adjustment flows from a firm policy on charitable organizations or for other firm policy unrelated to personnel performance.

The print-out on revenue produced by personnel at standard rates as adjusted by foregoing billing adjustment then becomes a useful management tool in evaluating personnel.

Journal of Accountancy, *June 1970*

1040s and Referrals

Samuel A. Derieux

Practitioners frequently debate whether or not they should bother with 1040s. Some advocate dropping them entirely, except those which cannot be avoided, and some claim that 1040 clients do lead to other engagements.

Just as business concerns must evaluate the relative profitability of products, accounting firms should determine the relative profitability of the various services they perform. However, such an evaluation should take into consideration more than the dollars that each type of service contributes to the overhead and profit of the firm. Some services may be a source of referrals of other, more profitable, work to the firm. This subject is of particular interest in considering whether or not it is desirable for a firm to prepare individual income tax returns in substantial numbers.

For several years, our firm has followed the policy of accepting individual tax return clients, but not encouraging this type of work. We feel that if we refuse to accept individual income tax return clients, the person who referred the potential client to us may get the impression that we are not interested in having *any* clients referred to us. We also recognize that work which begins as nothing more than the preparation of an individual income tax return frequently grows into extensive and desirable work.

In order to test this policy against facts, we made a list of 155 partnership and corporation clients and traced them back to the original source of the referral with the results shown in the table on page 299.

It is interesting to note that the largest source of referrals is from business and professional individual tax return clients. This is due partly to the fact that many of our professional partnership clients began with the preparation of an individual tax return for one member of the partnership, perhaps before the partnership was formed. The

	Related to Prior Preparation of Individual Income Tax Returns	Unrelated to Prior Preparation of Individual Income Tax Returns	Total
Source of Referral			
Individual tax return clients who are business and professional men and women not specifically named in other categories	40		40
Acquaintances, both business and personal, who are not clients		32	32
Clients other than individual tax clients		24	24
Attorneys	2	20	22
Contacts through civic and similar organizations		14	14
Individual tax return clients who are not business or professional men and women	11		11
Bankers	2	5	7
Stockbrokers	2	3	5
Totals	57	98	155

second most numerous category was that of friends and acquaintances who became clients as a result of that relationship or who, although not clients themselves, referred clients to us.

The table is based on the number of clients and does not give any weight to the nature or extent of the services performed for the partnerships or corporations. Although fewer in number, those clients referred by bankers and stockbrokers are larger in size and their potential value to the firm is greater than those in some of the other categories.

Since 57 out of 155 referrals were directly related to the prior preparation of individual income tax returns, this study seems to lead to the conclusion that the nuisance factor in the preparation of such returns is offset by the potential for new client referral. Therefore, we conclude that individual income tax return clients are a valuable source of referrals and that such clients should be accepted provided an adequate fee can be charged for the preparation of the individual income tax returns.

The Case Against 1040s

Joseph N. Switkes

Samuel A. Derieux, describing his experiences with "1040s and Referrals" concludes that while preparation of 1040s involves a nuisance factor, it is offset by the benefits of related referrals. We agree with Sam that 1040 work is a nuisance but disagree with him that the referrals make it worthwhile. It is a subject of great interest to many of us—I would like to expand on it and present our viewpoint.

Sam's procedure in testing his policy against facts is rational and systematic but I feel that the real answer to this problem will not be provided by simplistic reference to charts and statistics. While they might produce certain guidelines, the final decision must be based on data available only through the medium of experience in having lived with one's practice—that is, through consideration of all component factors and not merely whether a referral originates through an attorney for whom a 1040 was prepared or through a banker who is not a 1040 client.

Factors to Be Considered

What factors? Practitioners' goals and objectives, fee scale, client composition, level of staff personnel available to do the work, and type of service comprising the bulk of the practice work load, to name just a few. Obviously, the neophyte practitioner with a surplus of time and very few clients, doing all of his work himself, will probably encourage 1040 work, and rightly so, while an established practitioner, who is busy with other work and delegates most of it to some staff member, might feel otherwise about preparing 1040s.

The question of whether to encourage, discourage, or refuse 1040s is one of those practice management problems best answered by reference to prior experiences and visceral instincts. I feel that accountants frequently fall into the trap of relying on a worksheet or schedule as a panacea. Unfortunately, it works only in certain cut-and-dried situations, but not in this case.

Applying Sam's chart to our practice discloses that 94 percent of referrals fall into the "unrelated" category, that is, from sources having nothing to do with 1040s. Obviously, based on the same chart, our conclusions to the problem will be almost the opposite of those reached by Sam. I would guess that the clientele of a dozen practices tabulated the same way will produce a dozen different results. Perhaps this lends some validity to the effectiveness of the chart and to Sam's conclusions, but the fact that it raises more questions than it answers makes me doubt its usefulness.

Is it certain that the 57 referrals occurred because the accountants prepared a 1040? Or might they have occurred anyway because of the "non-1040" exposure which the accountants had with the person referring the client? If so, would "non-1040" exposure to these same people have resulted in the same referrals? Or more referrals? Or better referrals? Since 98 partnership and corporation clients are in the category unrelated to 1040s (against only 57 related), should not all available time and effort be directed toward a more intensive contact with the more productive group of 98? Is the nuisance of preparing 1040s eroding the accountants' time which could be better used to exploit the untapped potential existing in other "unrelated" groups? At what point does the preparation of 1040s cease to be merely a nuisance which is tolerated in exchange for the value of referrals and become a serious handicap to the orderly conduct of the rest of the practice when even the referrals do not provide the incentive to continue the pattern?

There are accountants who adore 1040 work and others who despise it. I have no doubt that some practitioners are equipped to cope with a large volume of 1040s and produce a good profit from this work. Any practitioners who are doing a thorough job, adequately representing their clients, and not working unreasonable hours probably have geared their offices to cope efficiently with this type of work, which in turn must comprise a major segment of the practice. No practitioner (or even a firm which has produced a fair degree of specialization) can be all things and do all kinds of work at all times for all types of clients. If he tries to do so, something will suffer—his work, his clients, his standards, himself.

We accept individual tax return clients in isolated cases depending on the merits of the specific situation. We go further than merely not encouraging this type of work—we discourage it as much as possible. We find that, with few exceptions, it is unprofitable for us, unappreciated by clients, unchallenging, and a nuisance. It is our experience that, while referrals sometimes develop from this type of work, overall "cost" of performing this service far outweighs the value of the referrals. This applies equally to the 1040 you do gratis for your favorite cousin (you know, the one who pleads poverty but *must* have his return finished by March 20 or miss the three-week cruise he will take while you are busy wondering what is wrong with the profession) and the one which produces a $1,000 fee.

Ten Reasons NOT to Do 1040s

If we should take into consideration the fringe benefits of referrals and not merely the dollar profit in deciding whether to perform this work, then it follows that we should also consider the indirect (and frequently overlooked) costs in addition to the specific dollar expenditures. Some items which sour us on this work include the following:

1. The typical 1040 client does not have an understanding or knowledge of the assignment to appreciate properly what is required to comply with his request. In his mind, you are "filling out a form," sort of a census questionnaire. If you give him a fair shake and are as devoted to a professional job on his return as you are to your regular work, you know how involved the job can become. The gap existing between what the client thinks you're doing and what you know you're doing manifests itself in many misunderstandings.

2. Many 1040 assignments (and any related state, county, and city returns) have gravitated in 25 years from simply inserting some elementary data onto a W-2 form, thereby completing the return, to a complex research project involving top-level personnel with lots of experience and knowledge. When a prospective client tells me "my return is simple," I try to remember what happened the last time we took an assignment based on that promise. Just this past tax season we were saddled with a few "simple" 1040s which produced the need to research, develop, and refine answers to an installment sale, throwback tax credit, depreciation recapture, basis change on an estate distribution, income averaging for a widow with determination of items of income between husband and wife during base-period years, just to mention a few that come to mind. These were unique problems, not merely "fill-in-the-form" matters. I will concede that an element of stimulating challenge exists in being presented with these questions, but "I wouldn't want to live there."

3. Referrals stemming from 1040 clients, which hopefully would make the preparation of 1040s more palatable and sweeten up the bad taste, all too often turn out to be more of the same diet. We find that 1040s tend to breed more 1040s. And frequently the job we have to do for the "referree" is more troublesome than the one we do for the "referror."

4. The rewards of the assignment, even including referrals, are almost never commensurate with the responsibilities we assume. We all must ensure that on each return an average of perhaps 100 separate

arithmetical computations be correct, that the substance of the return be proper (e.g., utilization of appropriate elections for tax savings—retirement income credit and exclusion of federal interest income on the state return—not be overlooked), that our status as practitioners before the IRS not be jeopardized, and that we comply with the requirements of the AICPA Statements on Responsibilities in Tax Practice. We view trying to equate the duties and the goodies as a masochistic exercise in futility and prefer to avoid it whenever possible.

5. The 1040s must be prepared during our busiest season. Even worse, having to wait for data from the client and from partnerships in which he has an interest usually results in 100 percent of this type of work being done in 10 percent of our work year (i.e., approximately March 10 to April 15). While we cope comfortably with the usual peaks (and valleys) peculiar to our profession, we are aware that it is more rational to minimize the need to scale a peak as troublesome as this one. With this goal in mind, we have increased fees, established minimum fees, increased minimum fees, established hourly fees. We have tried the gimmicks such as pro formas prepared in advance and questionnaires prepared by clients. We have tried the "any-child-can-do-the-input-sheets" computer-prepared returns. All the maneuvering helps somewhat but not enough to stimulate us to want to take on more work when we are already overloaded.

6. Because of the limited filing period, the extra work load necessitates more work at night and on weekends which in turn results in poor staff morale (and how about my morale—important?), disgruntled employees, overtime pay, and disproportionately high per-diem costs for other accountants who assist us at that time of the year.

7. The most important reason we shy away from the 1040 client is that this work seriously interrupts and disturbs the work we must do for our regular clients at the same time. There is no question that the creative aspect and overall quality of our regular work suffers to whatever degree we are harassed and pressured by other influences. The 1040s, at least in this office, constitute one of those influences. We cannot afford to jeopardize our relationship with year-round clients, nor our adherence to prescribed standards, by catering to the once-a-year 1040 client. I have noticed that the closer we get to April 15, the more frequent are the responses to the critiques from the 1040 reviewers, which start to read, "let it go," "not important," "forget it," or other comments indicating there is not enough time to do a proper job. We like to have our office function during the tax season almost as it does the rest of the year. We avoid any work which handicaps this principle.

8. We frequently find ourselves in a completely untenable position of playing the role of a sort of cushion which is expected to absorb the impact of tax laws requiring extensive compliance efforts, on the one hand, and the client, on the other hand, who cannot or will not pay the

fee needed to compensate us adequately for those comprehensive services. While we as professionals are supposed to serve the general public, and do in fact strain to preserve a certain dedication to our clients, this dedication does not become a duty to rescue those taxpayers who must pay enormous fees to comply with the law. Yes, we do get into the philosophy of practice when deciding whether to do 1040s. If the Congress creates severe reporting problems via the tax laws being enacted, then Congress, not us, should do something to alleviate the burden. Maybe it could legislate subsidies for the preparation of returns, furnish free assistance to the small taxpayer on a broad scale, or simplify the laws. Since Congress has not invited me to help solve its problem and since I have barely enough time to solve my own, I won't deal exhaustively with that subject here. However, we refuse to work on Sunday (or any holiday, for that matter), and we will not permit even mild friction to develop between us and a client solely to smooth out what is in reality a knotty problem which we didn't create or bargain for and for which we feel no responsibility. We hate to spend a lot of time doing a job for a client and then be forced to make a "conscience" adjustment in the fee, not because the work was deficient, but because we feel the client can't afford the charge.

9. We believe that 1040 work is not compatible, functionally speaking, with the other work done in this office. Not because it is degrading—it isn't—but because the procedures and methods required to perform one kind of work are frequently in conflict with those required to perform the other. These conflicts, in the areas of staff scheduling, fee structure, work flow, routing systems, review techniques, etc., eliminate or at best reduce the anticipated profit. The name of the game is profit. Flinching at the mention of the word changes nothing. I don't know of any firm which is geared to handle year-end 1040s efficiently along with their other work. Perhaps there are some. A crude analogy would have an electronic equipment manufacturer contracting to repair a radio for a consumer—in the midst of his busy production season! Perhaps most practitioners realize the folly of handling a mass of 1040s but continue to do so for various reasons—they hope that some day the *big* referral will occur, or they enjoy the excitement of spreading themselves thin, or they like the greater variety of work in their office, or they enjoy the challenge to their versatility, or whatever. While we have no quarrel with them and even indulge in these practices ourselves in moderation, we prefer to call a halt at the point where the relative lack of profitability of this service obviates perpetuating its existence.

10. The cost of administrative and nonchargeable time is disproportionately high for this type of work when compared to the normal services we render. It isn't unusual for brief phone calls with 1040 clients and other accountants, setting up files, setting up accounts receivable records, reviewing the time records, sending our billings

(maybe five or six times in a few cases), recording collections, answering queries during the year about estimated tax, and other similar matters for which no charge is made, to total perhaps two to three hours per job. This could represent 50 percent or more of the total billing for the job, whereas these costs are never more than 5 percent of our normal billings. And what about fees never collected?

We do not see any merit to the fear that refusing 1040s will create the impression with the person referring the work that we are not interested in *any* referrals. We are in close contact with the people who refer work to us, and we find that a brief explanation sets the record straight and usually proves to be a good public relations move that results in better-quality referrals from the same people. Lawyers who accept referrals of tax cases but refuse collection work, and architects who design office buildings but refuse to do single-family residences don't have this problem. Why should accountants worry about it?

Regardless of your viewpoint about this subject, it certainly is a healthy sign that accountants are evaluating the extent of their involvement. Review and assessment of the matter is the first step toward reaching the correct conclusion and will undoubtedly shield us from the plight of the plumber who spent 15 minutes replacing a washer in a faucet for a housewife and presented her with a bill in the amount of \$50. When she complained that the bill was too high with the comment, "My God, our CPA does our annual tax return for \$50," he replied, "I know lady, I know, I used to be a CPA."

MAS and the Local Firm—Lost Opportunities?

T. Dale Brigode

During the past year I have been conducting a study to determine the extent and scope of management advisory services being offered in Indiana, Michigan, and Ohio. I wrote to over 250 local and regional public accounting firms whose activities indicated that there were five or more permit holders in the local office. A few firms presented data that they were performing advisory services. Several firms indicated that their practices were limited to small tax clients or that they performed writeup work. Another group answered my telephone follow-up call with a statement that "they did all that was necessary." Further questioning indicated that they only told their clients of problems they personally recognized and could "handle" themselves.

I was able to meet with over 160 firms and determine what MAS meant to them. The scope of activities was generally in financial consulting—cash forecasting, assistance in obtaining bank loans, accounting systems, valuations of physical inventory, etc.; and computer consulting—feasibility study of desk size and small-scale machines, selection of manufacturer and configuration of equipment, advice in training and implementation of operating programs, etc.

Although most of this work was classified as management advisory services, very few firms believed they were complying with the AICPA Statement on Management Advisory Services Practice Standards issued in January 1975. An alarming percentage of firms that billed their services as MAS weren't aware of this publication or its implications for ethical practice if their competence and experience were subsequently challenged.

Informal advice is and should be offered to the client. After all, the public accountant probably has more knowledge about the client's business than any other adviser available. The practitioner is in the best position to see problems developing and to offer suggestions to minimize or eliminate these lost profit opportunities.

Many individuals or firms are hesitant to refer work to other professionals, believing their own qualifications would then be questioned. However, the problem for the public accountant is the acquisition of technical MAS experience in a broad range of specialized services, and the development and maintenance of a high level of competence.

A. Marvin Strait, CPA, pointed out that more practitioners must be convinced to recognize and identify advisory services as an integral and indispensable part of their practice. His concept of the cooperative venture, wherein several firms take an equity position in a subcontracting MAS company, is unique. The need to provide specialized competence is particularly difficult for the regional and smaller firm, where the client base is not sufficiently large to create a demand, on a continuing basis, to justify the addition to staff of the required full-time specialists.

Informal Cooperative Engagements

An alternative to a partnership agreement is an informal arrangement with a management advisory services firm, such as the one with which I am associated. The public accountant initially identifies an MAS situation and refers his client to the independent advisory service firm. This firm has the specialized technical personnel whose broad experience includes commercial, consulting, governmental, industrial, professional, public administration, retailing, etc. They have developed and maintained a high level of professional competence over a number of years.

Wherever possible, the staff personnel from the local public accounting firm assist on the engagement. The proposal letter to the client outlines the assistance of the local firm, the estimated cost, and a statement that their fees will be billed directly by the practitioner.

There are at least three benefits for the client. Preparation, research, and documentation time are reduced since the public accountant makes the permanent file, flow charts, etc. available. The staff person knows the contents and retrieves the data as needed during the MAS engagement.

A second benefit is obtained during the time-consuming first phase, when data is accumulated. The technical specialists have designed the work program so that portions can be turned over to the assistants for fact-gathering. Even on a production control study, where an accountant usually has limited knowledge, data must be collected and verified before an experienced industrial engineer can begin to evaluate and develop alternative recommendations. A side benefit to the accounting firm arises because the staff personnel have the opportunity to work with nonaccounting professionals whose academic and work experience differs. This is a challenging, educational experience not usually available in public accounting.

The third and perhaps most important benefit for the client develops during the implementation phase of the engagement. This phase includes training, conversion to new procedures, educating individuals in the use of the procedures, indoctrination of replacement personnel, and continuous explanation in the use of the information generated. This part of the engagement, although usually only 10–15 percent of the total time, can never be considered finished. The staff personnel become an integral part of this phase; their contribution has been excellent—usually better than the consultant, who has been too close to the design and is thinking of the next assignment and the challenge to develop new, alternative, and economical procedures for that client. During conversion, at the small- and medium-sized clients where internal staff is usually nonexistent and the level of competence may not be the greatest, problems must be caught, the proper procedures demonstrated, and the error corrected—all in a minimum of time. The local staff person is right in town, a half-hour's drive away.

The long-range implementation, or handholding, develops on an informal basis—as part of the normal tax or audit work. If so-called "correct" procedures still can't meet the system's objectives, then the cooperative MAS firm can be called back to find the problem. The client continues to be served.

These cooperative engagements, however limited, permit the local practitioner to earn fees, be aware of the progress, and be informed of why alternative solutions were offered. They would also have the client's continuing interest and could make annual appraisals of the implemented services.

Expanded Services to Clients

This informal cooperative MAS engagement allows access by the practitioner, who may have only one referral a year, to the broad range of technical competence inherent in an independent MAS firm. For the larger public accounting firm that desires to develop an MAS department, access to the managerial talent and training methods used by the advisory firm is ideal. With no investment in dollars or personnel, two or three individuals could be designated as the "cooperative" staff, who would assist only when needed on an engagement. As the value of time accumulated grows and staff personnel become more proficient in identifying and defining client needs, utilizing the analytical approach and process, and applying their knowledge of a technical subject, they could assume more responsibility on an engagement. Ultimately, a firm could have five or more full-time people in its MAS department and use the cooperative MAS firm for managerial control. Other specialized technical assistance would be referred in instances where a firm cannot economically staff for these procedures, which only require a professional three or four weeks a year.

Outline of a Typical MAS Relationship

The following is an outline of services performed for a warehouse distributor over a period of eighteen months.

Client Information

This metropolitan distributor has averaged $300,000 of inventory, $1 million in sales, employing eight warehousemen/drivers, three salesmen, two office employees, and two owner-managers. About 55 percent of sales are maintenance and repair items for industrial customers, 30–35 percent are sales to building subcontractors, and the remainder are sales to retailers—principally hardware stores. It will sell over 5,000 individual items during the year but will generally stock only about 2,500 at a time. Many of the contracted items are temporarily stored in the warehouse but are not considered inventory.

The company has always been able to outperform the economy because of the aggressiveness of the owners and their reputation among their industrial customers of dependable delivery service.

The principal owner identified the company's immediate problem as follows: "Should management buy a computer? Everyone seems to be doing it. Maybe we need one." A longer-range concern was to develop the organization so that he wouldn't have to put so much time in the business—two seemingly divergent goals.

General Management

We have found that the best starting point for any advisory engagement where the client has stated two or more general problems is to document long-range profit-planning procedures.

We were able to determine very quickly that the clients in this instance had never clearly established what they wanted out of their business, nor had they inventoried their capabilities. We began the engagement by analyzing the strengths and weaknesses of the enterprise. The two owners were given suggestions on how to develop strategy—formulating what they believe will be the company's opportunities in five to ten years. We asked them if their current operations, products, personnel, and markets can function in tomorrow's world. Our suggestion that they consider the world was ludicrous to them until they were reminded of what the oil price increase had done to the cost of plastic pipe they sell and how their aluminum products could be affected if the ore-producing nations banded together.

The company's prefabricated units and building modules hadn't gained as much reception as indicated in prior years' projections, but sales were growing at an increasing rate and would affect their subcontracting customers. We had to convince the owners that they must draft a business plan and establish tentative objectives. This exercise forced them out of the day-to-day operational mode and they began to evaluate alternative strategies, policies, and priorities. After three months, they agreed on a strategy. It was presented to their board of directors for discussion. At our suggestion, they had replaced the bankers and lawyers with outside businessmen—not competitors, but individuals who had a wider perspective of the business community and international economics. These independent advocates challenged the proposed strategy and made the owners want to revise their thinking. The exchange of ideas, thoughts, and positions at that first meeting was productive.

Subsequently, a five-year operating plan was prepared, so that current decisions, when made, could be evaluated against these interim bench marks. In the second year of the operation, about a third of the strategic plan was changed. Although this sounds like a large proportion, it must be remembered that two-thirds did remain intact. Little effort was wasted in the first year of the plan because the owners weighed each of their actions against the tactical and the strategic plans. They made changes immediately. The owners admitted that day-to-day managing was becoming easier and decisions were made more quickly. The nagging thought that they could have made a mistake was balanced against the overall business plan. "If it fits the plans, do it now. If it doesn't, subject it to further study."

Computer Application

We reviewed the feasibility of a computer in three phases. The first was the marketing function of order entry-billing-credit and marketing information. The second was inventory management. The third phase was preparation of financial statements and accounting function.

We identified the company's principal problem to be limited or inadequate marketing information. The company required data on margins from customers; product lines; suppliers; and sales classes. Other information such as cost of processing orders, cost selling by customer class, and sales margins by salesmen and house accounts also were needed.

The inventory management procedures worked at the present volume level even though they were manual. All contracted goods were purchased for a subcontractor and generally shipped directly. Inventory items for industrial and retail customers were purchased when visual inspection of stock during the biweekly visits of manufacturers' reps or salesmen showed they were low. Popular, fast-moving items were known and observed by all employees. Our principal recommendation was to red-tag "critical" products when an order was received so that delivery could be ensured.

The accounting and financial statement preparation was not very complicated or time-consuming. The two office workers were capable of handling all routines including billing.

We could not justify the cost of owning or leasing a computer. We did however recommend a local service bureau to prepare invoices and marketing reports. Sales personnel have always priced orders and the office workers checked them before preparing the invoices. By eliminating the preparation of sales invoices in the office, these people also had time to cost price the orders. A computer file would have been impractical for checking sales price and picking up a cost value because there was such a mixture of supplier numbers, special descriptions, and sizes.

Conclusion

The long-range planning procedures worked out by an industrial management specialist required the owners to devote research time to develop a long-range plan to help them in future decision-making. They have already realized that soon they must bring along someone in the organization to take over management. The alternative is a sale or merger, initiated by them for their economic advantage. We anticipate that our industrial psychologist will be able to assist them in evaluating present personnel and all future managers.

The development of the sales-margin reports was prepared by a marketing information specialist. He also assisted in writing job descriptions and establishing a salesmen bonus plan.

The computer operating programs, although developed by the local service bureau, were reviewed by a computer analyst before the client implemented the procedures.

The inventory management review was conducted by an industrial engineer experienced in inventory control. He also outlined storage and part identification procedures the company could follow as their volume increased.

Each associate contributed three to five days on the engagement.

The company has a stated objective, well-understood policies, an informed organization and its owners are now less harassed.

This engagement demonstrated that an advisory service is typically unspectacular. Modest improvements in management practice, cost avoidance, productivity, or efficiency comprise a reasonable and realistic goal for any client.

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The Minicomputer: Accountants' Sleeping Giant

Jesse T. Barfield

A phenomenon is developing which I believe will radically affect all types of accountants but, in particular, the local CPA. If we seize this moment and react by preparing ourselves, the awesome proliferation of minicomputers which is about to occur can become one of the greatest blessings in history for us.

H. J. Ridinger, noted author and consultant on EDP systems, estimates that the computer industry in this country will be delivering 2,400 minicomputer business systems per month by the end of 1977.[1] From there it's probably anybody's guess as to the growth of the trend of such installations. However, it is interesting to note that the Bureau of the Census reports that 96.9 percent, or about 12,048,000 firms, of the total number of U.S. businesses in 1971 had less than $500,000 in annual receipts.[2] Many of these firms have to be candidates for owning their own computerized accounting systems.

Two forces are presently at work to promote this expected expansion. First, modern technology allows hardware manufacturers to compress massive computing power into small packages which can be turned on and off with the flick of a switch and which do not require such things as raised floors and special cooling. Second, the price of hardware has been lowered to a sixth or seventh of what it was twenty years ago and by at least 50 percent in cost from four years ago.[3]

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1. H. J. Ridinger, "Crisis in Applications Software," *System/3 World,* March 1976, pp. 5–7.
2. U.S. Department of Commerce, *Statistical Abstract of the United States—1974* (Washington, D.C.: Government Printing Office, 1974), p. 477.
3. "Small Business Computers," *System/3 World,* November 1974, pp. 6–7.

The Cost of Not Reacting

Failure to react to the mini's potential as an accounting and management tool can, and probably will, cause the CPA to relegate himself to a much lesser role in financial information processing. Historically, financial information processing for small business has been, almost entirely, the bailiwick of the local CPA.

Ultimately, the local CPA has no choice in the matter because he will soon be frequently asked to audit EDP accounting systems for small businesses.

If we prepare to be in control in the sense that we can properly advise clients regarding the if, when, what, how, how much, and why of EDP accounting systems and then actively participate in the implementation of our recommendations, we can happily maintain our position in financial information processing and reporting. By failing to react now to what we must sooner or later do anyway, we will find ourselves reluctant passengers rather than engineers.

Historical Perspective

Most CPAs educated under a university curriculum which emphasizes manual systems do not yet possess an integrated knowledge of accounting and EDP systems.

In the early 1960s modern EDP systems began to become important to business firms. Since then the scope and frequency of use of EDP systems have grown with awesome rapidity and pervasiveness. During this time many accounting faculties at U.S. universities ignored this phenomenon by rationalizing that only large CPA firms serviced clients large enough to justify the acquisition and operation of computers. Such large CPA firms hired nonaccounting specialists to train accountants "in house" after graduation.

Now available is the powerful, low-cost minicomputer, which is practical for a vast number of small businessmen. The local accountants who serve these clients will not be adequately trained to assist their clients if university accounting facilities continue to teach only the traditional material.

Problem Solving Versus Systems

"Being trained" involves much more than merely learning a programming language. A critical distinction for accountants should be made between using the computer for problem solving (a language programming course such as COBOL or FORTRAN generally is adequate) and using the computer to accomplish systems data processing.

The latter involves capturing data efficiently (e.g., it is now becoming common to capture data on line which will update accounting records instantly and accurately as the transaction occurs), drawing on stored common data base information to transform and generate more usable information, updating a series of records and files, and printing reports at the appropriate time. I have seen all of the above on-line, real time operations being performed on a modestly priced minicomputer.

To give an example of the use of systems techniques involving common data entry, common data base files, and an interlocking series of data processing programs, consider the handling of payroll processing for a building contractor:

A single set of data would be keyed in (e.g., employee number and hours worked by job codes) and matched with an employee number in the common data base files (containing such information as employee names, pay rate tables, and formulas for computing deductions and assignment of costs). The combined input and stored data would be meshed and manipulated to—

1. Prepare checks.
2. Prepare and list a transaction journal.
3. Update general ledger accounts (e.g., cash, payroll taxes payable, and work-in-progress).
4. Update the affected jobs in the job cost subsidiary ledgers.
5. Update the individual employees' payroll summary ledger accounts.

Further, at the appropriate time, the same common files can be drawn upon to prepare listings of the general ledger, subledgers, various internal and external accounting reports, payroll tax returns, and other external reports such as job status reports required from contractors by governmental agencies.

Note that a great deal of data processing and financial information results from a one-time keying-in of a few pieces of data. For repetitive processes such as payrolls, sales for cash and on account, inventory control, and production, EDP accounting systems should fulfill the accountant's dream.

Modern EDP systems techniques include other advantages. For example, some types of decision-making for which the decision rules are well established can be handled by the computer. Examples include preparing purchase orders when inventory reaches a pre-established reorder point; processing sales invoices, warehouse requisition documents, shipping documents, etc., for smaller sales orders if the requesting purchaser's account history is adequate; and scheduling production and allocation of manpower to various tasks to accomplish a project according to findings of a critical path analysis.

Unique Difficulties

In one sense, local CPAs who are to become involved in recommending and implementing EDP accounting systems for small businesses have a greater challenge than large CPA firms. First, minicomputer systems, the hardware of which can be switched on and off nearly as easily as a lightbulb, are frequently operated by the client firm's own previously existing personnel who have had limited or no computer and systems exposure.

Second, CPAs servicing large businesses have cooperated with and learned from the client's EDP systems personnel as well as the firm's own in-house specialists. Small CPA firms won't usually enjoy this luxury. Practically all of the basic administrative and operating functions performed on large EDP systems also are performed on a limited basis in small EDP systems. Further, the small firm manager frequently doesn't know how he arrives at many of his decisions and, therefore, he doesn't know what kinds of reports will help him. In this context, EDP accounting systems in small firms pose an even greater challenge for the local CPA than do larger systems for the large CPA firm.

The Challenge

We are on the verge of a set of circumstances which affords us a golden opportunity. Somebody is going to assist our clients to decide whether their information needs can be better served with a minicomputer than by traditional approaches. Will that somebody be the same person who assisted the client with the original decision? Isn't he the logical candidate to plan, design, implement, consult with, and assist in the continued operation of the recommended system? If such a person is not the CPA, then the CPA may find himself standing on the outside looking in with regard to the continued needs of clients for information processing.

Such a development would be most unfortunate because I happen to believe that to effectively perform the above services, a person should not only be expert in computer systems but should also possess the kind of rigorous understanding of finance and accounting for which CPAs are known.

But if accountants are to be in control, then we must be willing to develop some new skills. In general, we must learn how to perform, unassisted by outside systems specialists, the following functions:

1. Survey of client information needs (accounting and operating).
   a. Feasibility of EDP system for the particular client.
   b. Alternatives for acquiring EDP hardware and software available to the specific client.

   c. Application of EDP system to satisfaction of client's data processing and problem solving requirements.
2. Survey of appropriate vendors to satisfy client's computer hardware and software needs and assistance in selection of vendors able to most effectively and efficiently deliver such satisfaction.
3. Designing of EDP system to satisfy the specific needs of clients.
4. Consulting with client with respect to contract negotiations with hardware and software vendors.
5. Implementing the system and training personnel to operate it.

However, the ability to perform the above functions unassisted presupposes that the CPA possesses an understanding not only of systems concepts but also of the way computer hardware and software operate. Knowledge of these can be acquired through continuing professional education or college course work that covers—

1. One or several user languages for business such as COBOL, RPG or BASIC.
2. A working knowledge of EDP file structures, preparation, maintenance, and control. See, for example, the discussion by Thomas Porter.[4]
3. An understanding of assembler language (a language which is a man-sensible language but which is much closer to the true machine language which actuates the computer).
4. An understanding of the computer operating system to be used so that its capabilities and limitations are recognized and so that such operating systems can be modified where appropriate to function most effectively and efficiently. The operating system is the set of software programs provided by the hardware vendors that controls and monitors the user programs to be run on that hardware.
5. A working knowledge of EDP systems design. This means blueprinting the types of computers, peripherals, programs, and people to process the types and volume of information required by the particular client in a controlled, efficient, and effective manner.
6. A working knowledge of the operation and management of a minicomputer installation.

Because accountants will be asked to audit the EDP accounting systems for small businesses more frequently in the future, why not prepare to better assist our clients in modern information processing? After all, information processing is an undertaking which has traditionally provided us much income and satisfaction.

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4. W. Thomas Porter, *EDP Controls and Auditing* (Belmont, California: Wadsworth Publishing Company, Inc., 1974), pp. 8–20.

The Demise of a Family-Held Business

Richard C. Rea

One of the few advantages of being older is that you can say things to clients that younger men would not dare to say, and another is that you can often draw on many years' experience and give your clients sound advice, if they will listen.

There are times when even an older CPA will hesitate to call a client's attention to a situation which he considers dangerous, but which is in a sensitive area.

About a year ago I saw a predicament developing with one of our clients because of nepotism. The client himself did not see it. I felt that it was my responsibility, somehow, to bring it to his attention, but I was not sure he would want to discuss it.

One evening I was reviewing my past observations in this critical field and started a list of the reasons why so many family-owned businesses do not survive the second generation. As the evening wore on the list kept growing until I had nine principal causes.

As the list grew I felt more and more the urgency to call my client's attention to his unperceived problem. But how? Finally I hit upon a solution that should have occurred to me at the beginning.

For many years we have sent out, each month, a bulletin to our clients in which we discuss a wide range of subjects we believe to be of interest to them. Why not, I asked myself, publish this list in our monthly bulletin? There was, of course, a chance that my client might not read it, but because of the circumstances this was a chance I had to take. Fortunately, he did read it. The next time I saw him he introduced the subject himself, and we finally had the problem out on the table. I am not sure we have resolved the situation but at least he is aware of the danger.

Perhaps there are other practitioners who will find my list useful.

1. Family members are on the payroll who are not pulling their weight and key positions are filled by them regardless of qualifications.

2. Competent people with talents and capabilities needed by the company will not accept employment. They reason that there will be no future for them in the organization unless they are related to the family by blood or marriage.

3. Usually the board of directors consists entirely of family members, many of whom have had no business experience. Often these family members will attempt to use their positions as directors to further their personal ideas and desires without regard to the long-term welfare of the company.

4. Unfortunately, founders of family businesses usually fail to provide an estate which is independent of their investment in the businesses; hence the widows and other heirs may have no sources of income except from the family business. As a result, their principal interest is in how much money they can get out of it.

5. The founders of most family-owned businesses started with little or nothing, and operated the businesses more as dictatorships than as democracies. Policies were what they chose them to be and decisions were made with little or no consultation among the other members of the family. As a result, corporate records are usually inadequate if not nonexistent, and this habit of not keeping adequate records carries over to the succeeding generation, creating difficulties when the inevitable problems occur.

6. Founders of family-owned businesses will be inclined to look upon their children as "equal." Understandably they do not want to give the impression of showing favoritism, and will often leave the voting power and other authority equally divided. Unfortunately, all children are not equal. This failure to recognize that all family members should not have an equal voice in management results in internal dissension that can only lead to the deterioration and ultimate demise of the business.

7. Founders of businesses are reluctant to go outside the family to select a successor for management. Often this is advisable as none of the family are capable of managing the businesses.

8. After the death of the founder it is not unusual for the heirs to quarrel among themselves as a result of personality clashes and prejudices, and consequently business decisions are seriously affected.

9. Many founders fail to recognize the heavy estate and inheritance taxes which their executors will have to meet. This failure has caused many family businesses to be sold, and others, by meeting these tax burdens, to seriously impair their financial soundness.

All of these reasons can be overcome by careful estate planning while the founder is still active and in a position to make the necessary decisions without serious opposition.

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What Is It Like to Have a Fire?

Richard C. Rea

At 5:00 A.M. January 10, 1967, a fire totally destroyed the office of Morris Swedlow, CPA, Columbus, Ohio, and all but totally destroyed the office directly above him occupied by Frank Huling, CPA.

Both CPAs said, when they viewed the devastation, that their first impulse was to throw away the key, pack up, and leave town. But then clients began calling. All of them were sympathetic, offered to do whatever they could to help, and assured them they would be patient if extensions were needed for their tax returns. For the first time, Mr. Swedlow said, he began to realize the true meaning of satisfactory client-CPA relationships and how much his clients depended upon him.

The CPAs were prevented from entering their premises for two days until after the fire marshal had conducted an arson investigation. Meanwhile, the office supply dealers in Columbus had both practitioners completely equipped in temporary locations, and the telephone company had telephones installed within 24 hours. Other CPAs in Columbus offered whatever help they could give, including the loan of staff. The Internal Revenue Service assured them of their cooperation in granting extensions and offered to secure copies of prior years' tax returns if needed.

All this gave them the courage to undertake the staggering task of reconstructing their records and work papers and at the same time face the rigors of the tax season.

Both CPAs had valuable papers insurance and both found the insurance companies cooperative. They were surprised to discover that papers packed tightly in steel files, while charred around the edges, were still legible even though the files were not fireproof. Mr. Swedlow installed a copying machine and hired extra help to make copies of all charred documents, comparing each copy with the original to make sure that all figures were as legible as possible, and then the charred originals were destroyed.

Both men have excellent advice for those who have never experienced a fire.

- Do not leave papers on tops of desks and tables. These papers were totally destroyed, but those which were in drawers fared far better and the information they contained was for the most part retrievable.
- Keep an up-to-date inventory of all furniture, fixtures, and equipment.
- Take an annual inventory and be sure your insurance covers office supplies. As Mr. Huling said, you do not know how much money you have tied up in supplies and small items of equipment which are normally charged to expense until you face the cost of replacing them.
- While the papers stored in ordinary steel files survived better than had been expected, nevertheless it would be advisable to keep all papers in fireproof files, or at least the most valuable papers.
- Keep your staff informed of your plans. If they are conscious of your first wave of despair, they may panic and rush to get a job somewhere else, but if they know you intend to stay in practice and to reestablish your office, they may stand by you.
- Make it a policy to return all clients' records as soon as possible, thereby substantially reducing the risk of loss.
- Do not be in a hurry to settle with the insurance company. It may be a long time until some records are discovered to be missing.
- Make certain your bank microfilms all checks, etc. Mr. Swedlow's bank did not, and the task of reconstructing his own personal records was most difficult.

Mr. Swedlow received a settlement of $4,600 from the insurance company to cover the cost of replacing the records destroyed. They permitted him to include the value of his services at his regular hourly rate, but the other help which he engaged for this work was included at cost.

Since Mr. Swedlow had 2½ employees, this recovery would be $1,840 per employee. For many years I have been concerned as to whether or not our own valuable papers coverage was adequate, but I never had any data available. If I were to judge our own need for coverage based upon his loss, it would appear that we are carrying only half of the valuable papers insurance we should have.

The most significant comment Mr. Swedlow made was, "I did not know how nice people could be until I was in real trouble."